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IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 131.

THE ST. LOUIS AND O'FALLON RAILWAY COMPANY and MANUFACTURERS' RAILWAY COMPANY,

Appellants,

vs.

UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION,

Appellees.

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No. 132.

UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION,

Appellants,

vs.

THE ST. LOUIS AND O'FALLON RAILWAY COMPANY and MANUFACTURERS' RAILWAY COMPANY,

Appellees.

Appeal from the District Court of the United States for the Eastern Division of the Eastern Judicial District of Missouri.

BRIEF FOR APPELLANT RAILWAY COMPANIES

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IN THE

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THE ST. LOUIS AND O'FALLON RAILWAY COMPANY and MANUFACTURERS' RAILWAY COMPANY, *Appellants,* vs. UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION, *Appellees.*	No. 131
UNITED STATES OF AMERICA and INTERSTATE COMMERCE COMMISSION, *Appellants,* vs. THE ST. LOUIS AND O'FALLON RAILWAY COMPANY and MANUFACTURERS' RAILWAY COMPANY, *Appellees.*	No. 132

Appeal from the District Court of the United States for the Eastern Division of the Eastern Judicial District of Missouri.

BRIEF FOR APPELLANT RAILWAY COMPANIES.

The opinions delivered in the Court below (R., 125-140) are reported in 22 Fed. (2nd) 980

STATEMENT OF THE JURISDICTION.[1]

1. Nature of the Suit.

This suit was brought to enjoin and set aside an order of the Interstate Commerce Commission, made in the administration and enforcement of paragraph (6) of Section 15a of the Interstate Commerce Act. That paragraph provides that if, under the provisions of Section 15a, "any carrier receives for any year a net railway operating income in excess of 6 per centum of the value of the railway property, held for and used by it in the service of transportation, one-half of such excess shall be placed in a reserve fund" to be established by such carrier and to be used only for the limited purposes described in paragraph (7), and "the remaining one-half" (declared by paragraph (5) to be held in trust for the United States) "shall * * * be recoverable by and paid to the Commission."

The order of the Commission in question (R., 104), and its report, which was made part of the order by reference (R., 37, *et seq.*), (1) purported to determine (*a*) the value of the appellant, The St. Louis & O'Fallon Railway (called the O'Fallon) and (*b*) that it had earned an excess net railway operating income under Section 15a, during the periods and in the amounts stated in the report and order, and (2) directed (*a*) that one-half of such excess, declared to be held in trust for the United States, should be

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[1]This case was docketed and the record filed on May 9, 1928, nearly sixty days before the present rules became effective and this statement is made in compliance with rule 27(c) of such rules.

paid to the Commission, with interest, and (*b*) that the remaining one-half should be placed in a reserve fund as provided by the Act.

The Commission considered together, in its investigation of excess income, the O'Fallon and its co-appellant, Manufacturers' Railway Company (called the Manufacturers), which are in common management and control. Section 15a provides that the value and income of "a group of carriers, which the Commission finds are under common control and management and are operated as a single system, shall be computed for the system as a whole, irrespective of the separate ownership and accounting returns of the various parts of such system." Appellants contended before the Commission that they were operated as a single system. The Commission found otherwise. Having determined the income of the Manufacturers, the Commission found that it was unnecessary to determine its value, because it was apparent that it had no excess income.

The order was attacked below upon the ground, among others, that the Commission's finding in respect of single system operation was contrary to the evidence, and based upon a misinterpretation of the statute; and that hence, there being no finding, and no basis for a finding, as to either the value or the excess income, if any, of the two railroads as a single system, the order was void (Petition, par. 13, R., 10-16). It was also attacked upon the following grounds, among others: (1) that the income of the O'Fallon during the periods in question did not arise under Section 15a and, hence, that it had no recoverable excess income, held no funds in trust for the United States, and could not be required to set up a reserve fund (*ib.*, 24-25,

R., 24-27); (2) that the reserve fund provisions of the Act, by reason of the limitations imposed upon the use of such fund, contravened the Fifth Amendment (*ib.*, 27, R., 27) (3) that the Commission's findings of value, upon which the determination of excess income was based, were erroneous in law and contrary to the evidence (*ib.*, 14-23, R., 18-24); and (4) that, upon various grounds, the order deprived appellants of their property without due process of law.

2. The decree below.

The case was tried before a statutory court, consisting of Circuit Judges Stone and Van Valkenburgh and District Judge Faris (R., 118-119).

The final decree, entered December 19, 1927 (R. 148-149), annulled that part of the order providing for the payment of interest, and in all other respects dismissed the appellants' petition. Appeal was allowed on February 8, 1928 (R. 150-152), within sixty days after the entry of the decree.

3. Jurisdiction of the Court below.

The jurisdiction of the Court below was invoked under the provisions of the Urgent Deficiencies Act of October 22, 1913, 38 Stat. L. 208, 219, which vested in the District Courts the jurisdiction theretofore conferred upon the Commerce Court by Act of June 18, 1910, 36 Stat. L. 539, over "cases to enjoin, set aside, annul or suspend, in whole or in part, any order of the Interstate Commerce Commission."

The jurisdiction of the Court below has not been attacked by appellees. The following cases are among those believed to sustain such jurisdiction:

United States v. *Baltimore & Ohio R. R.*, 225 U. S. 306;

Louisville & Nashville Ry v. *United States*, 238 U. S. 1;

Skinner & Eddy Corp. v. *United States*, 249 U. S. 557;

Chicago Junction Case, 264 U. S. 258;

United States v. *Abilene & Southern Ry.*, 265 U. S. 274.

Unlike the orders reviewed in *United States* v. *Los Angeles & Salt Lake Ry.*, 273 U. S. 299, and *United States* v. *Kansas City Southern Ry*, 275 U. S. 500, the order was an affirmative order requiring action on the part of the carrier. It was required to place funds in a reserve and use them only for prescribed purposes, and to pay to the Commission an amount of money found to be held in trust for the United States. For disobedience of the order, the carrier was subject to the penalties provided in the Act. It is therefore believed that the reasoning of the *Los Angeles & Salt Lake* case and that of the *Kansas City Southern* case also sustain the jurisdiction of the District Court in the case at hand.

4. Jurisdiction of this Court.

The jurisdiction of this Court is invoked under paragraph (4) of Section 238 of the Judicial Code, as amended, which permits a direct appeal to this Court where such an appeal is provided in:

> "4. So much of 'An Act making appropriations to supply urgent deficiences * * *', approved October 22, 1913, as relates to the review of interlocutory and final judgments and decrees in suits to enforce, suspend or set aside orders of the Interstate Commerce Commission other than for the payment of money."

Reference to the Urgent Deficiencies Act shows that all suits to enjoin the enforcement of orders of the Commission were to be heard by a three-judge court, whose decision was directly appealable to this Court. The cases cited in support of the jurisdiction of the District Court are also believed to sustain the jurisdiction of this Court on direct appeal. The case below being one requiring that it be heard before a special statutory court of three judges, it is believed that Section 238 of the Judicial Code provides for a direct appeal in this, as in all other cases heard before such a court.

Since a part of the order involved in the present case requires the payment of money, it might appear, as a matter of first impression, that the case is not within the appellate jurisdiction of this Court under the phraseology of the Act quoted above. That impression would, however, be erroneous for the following reasons:

1. Because, however the phraseology of the Act may be construed, the order is as much an order "other than for the payment of money" as it is an order "for the payment of money." It is but a single inseparable order requiring the carrier to dispose of excess earnings pursuant to Section 15a, (a) one-half to the reserve fund

and (*b*) one-half to the United States. The validity of both directory provisions of the order depends upon a single issue, *i.e.*, the validity of the Commission's ascertainment of the existence and amount of excess income earned by the carrier; and the two provisions are inseparable.

2. Because, even if the two parts of the order should be regarded as separable, the jurisdiction of this Court, over a suit to set aside that part of the order requiring the creation of a reserve, is clear, and it therefore has jurisdiction over the whole case and over all the issues presented.

3. Because such a construction of the phraseology of Section 238(4) would be contrary to the intent of the Act of February 13, 1925, which enacted this section, and which was designed to preserve unimpaired the existing jurisdiction of this Court over appeals from all three-judge courts, merely codifying into a single section of the Judicial Code the provisions theretofore scattered among several unrelated acts, without intending to limit or qualify the existing jurisdiction over such cases. Under the Urgent Deficiencies Act, it was permissible to take a direct appeal to this Court in all suits brought to enjoin or set aside an order of the Interstate Commerce Commission, as such suits require a hearing before a three-judge court.

4. Because the part of the order which directs payment of excess income to the Commission, is not an "order for the payment of money," as that expression is used in the Interstate Commerce Act, with which the Act of Feb-

ruary 13, 1925, as well as the Commerce Court Act and the Urgent Deficiencies Act is *in pari materia*. That phrase must be construed as applicable only to orders for the recovery of damages.

It is believed that a statement of the foregoing reasons is sufficient to dispose of any suggestion as to the lack of this Court's appellate jurisdiction. If doubt remains, however, it is believed that it will be removed by the following further elaboration of the points set forth above.

(1) The order dealt with a single subject matter, i. e., the existence or non-existence of excess income and its proper disposition under the statute. Its directory provisions required payment of money to the Commission, and also required the carrier to set up and maintain a reserve fund. This latter provision was clearly "other than for the payment of money", and the case is therefore within the jurisdiction of the Court, whatever construction may be given to Jud. Code, Section 238(4), since appellants seek to set aside the whole order.

The fundamental inquiry in the Commission's administrative proceeding, the basis of the Commission's whole order, and the ground of attack upon the order as made, all relate to the determination of whether or not there was excess net railway operating income, within the meaning of Section 15a. If there was such excess income, the provision for payment of one-half of it to the Commission, and the provision for the creation of a reserve, are both merely directory of the disposition to be made of such excess, under the statute. If there be no excess, each of the directory provisions is void. If there be an excess, but less

than that determined by the Commission, each of the directory provisions is equally void, *pro tanto*. Both provisions are valid if the excess be as determined by the Commission. Both directory provisions are thus inseparable, not only because each is merely a part of a single order, but because the validity of each depends upon the same issue, *i. e.*, the validity of the Commission's finding of excess income. Furthermore, the attack on the order was based upon such grounds that, if sustainable, it is conclusive of the validity of both parts of it.

(2) Since the Court without doubt has jurisdiction to entertain the appeal insofar as it involves the provision requiring the creati n and maintenance of a reserve fund, the Court will assume jurisdiction as to the whole subject matter of the Commission's order, to determine all of the issues properly raised in the suit, under the familiar doctrine stated in *Camp* v. *Boyd*, 229 U. S. 530, 552, that:

> "• • • a court of equity, if obliged to take cognizance of a cause for any purpose, will ordinarily retain it for all purposes, even though this requires it to determine purely legal rights that otherwise would not be within the range of its authority."

This rule has always been applied by this Court to its appellate jurisdiction. See *McGowan* v. *Parish*, 237 U. S. 285, 291, 292; *McCurdy* v. *United States*, 246 U. S. 263, 269; *Ohio Tax Cases*, 232 U. S. 576, 586; *Louisville & Nashville R. R. Co.* v. *Finn*, 235 U. S. 601, 604; *Siler* v. *L. & N. R. R. Co.*, 213 U. S. 175, 191; *Greene* v. *Louis. & I. R. R. Co.*, 244 U. S. 499, 507, 508.

(3) Even if the reserve fund portion of the order be entirely disregarded and the recapture part of the order be regarded as an "order for the payment of money", a suit to enjoin such order may, nevertheless, be taken to this Court on direct appeal, because it is clear that Section 238 (4) was not intended to limit, or by implication to repeal, any part of the Urgent Deficiencies Act.

The Act of February 13, 1925 (43 Stat. L. 938), provides:

> "Sec. 238. A direct review by the Supreme Court of an interlocutory decree or final judgment or decree of a District Court may be had *where it is so provided* in the following acts or parts of acts, and not otherwise:"

The Act then describes the acts or parts of acts that gave the then existing right to a direct appeal,—which right was intended by this amendment to continue to exist. The fourth reference is to "so much" of the Urgent Deficiencies Act as relates to the review of "suits to enforce, suspend or set aside orders of the Interstate Commerce Commission other than for the payment of money."

The Urgent Deficiencies Act did not define the jurisdiction of the District Court or of this Court in cases involving orders of the Commission. It merely abolished the Commerce Court and transferred its jurisdiction to the District Courts, making no material change in the appellate jurisdiction of this Court (38 Stat. L. 220). The Commerce Court Act provided for a direct appeal to this Court in all cases over which the Commerce Court had jurisdiction.

The Commerce Court had jurisdiction in suits involving the *enforcement* of the Commission's orders only if such orders were "other than for the payment of money". There was no such limitation upon its jurisdiction in suits brought to *enjoin* and *set aside* orders of the Commission. The language of the statute, set forth in the margin, makes this express distinction.[1]

Thus the Commerce Court, under the act creating it, and the District Courts, under the Urgent Deficiencies Act, had jurisdiction of all suits to set aside the orders of the Commission; and in all such suits this Court had jurisdiction under direct appeal under those acts. The Act of 1925 shows no intent to limit or, by implication, to repeal, the provisions of the act as to appellate jurisdiction of this Court. The language was intended to be descriptive of the Act referred to, and to preserve the existing right of appeal in its entirety.

References to the published hearings before the Senate Judiciary Committee, which make this clear, are contained in the margin.[2]

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[1] The Commerce Court Act, 36 Stat. 539, committed to the jurisdiction of the Commerce Court, and provided for direct appeal to this Court in, the following classes of cases, among others:

"First. All cases for the enforcement, otherwise than by adjudication and collection of a forfeiture or penalty or by infliction of criminal punishment, of any order of the Interstate Commerce Commission other than for the payment of money.

"Second. Cases brought to enjoin, set aside, annul, or suspend in whole or in part any order of the Interstate Commerce Commission."

[2] The hearings before the Sub-committee of the Judiciary are published in a document entitled "Procedure in Federal Courts: Hearing before a Sub-committee of the Committee on

As bearing on the Congressional intent, it may be noted that any other construction of Section 238 (4) would produce this anomalous result: that although the three-judge court would still have jurisdiction to enjoin the enforcement of any order of the Commission, whether for the payment of money or not, the appellate jurisdiction of this Court would be confined only to a part of the jurisdiction retained by the Judiciary Act in the court below. This would be contrary to what is believed to be the obvious Congressional intent, to preserve direct appeals to this Court in all cases in which the court below was required to be composed of three judges. It would result in requiring, wherever the order of the Commission happened to involve the payment of money, an appeal from the three-judge District Court to the Circuit Court of Appeals, another three-judge court,—a result clearly not contemplated by the Judiciary Act in any case.

(4) The Commerce Court Act, the Urgent Deficiencies Act and the Judiciary Act of February 13, 1925, insofar as they relate to appeals in cases involving the validity of orders of the Interstate Commerce Commission, are *in pari materia*.

The phrase "orders other than for the payment of money" was borrowed from the Commerce Court Act,

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Judiciary, United States Senate, 68th Congress, First Session." The analysis of Section 238, at page 13 of that document, and the explanation of the section given by Mr. Justice Van Devanter, at page 33, leave no room for doubt that the provision in question was intended merely to be descriptive of the part of the Urgent Deficiencies Act which related to this Court's appellate jurisdiction, and was not intended to alter the provisions of that Act.

which dealt with suits to enforce or set aside orders of the Commission. When the Commerce Court Act was enacted, the distinction in the Interstate Commerce Act between orders "for the payment of money" and orders "other than for the payment of money" was well defined. The expression first made its appearance in the Interstate Commerce Act in the amendment of June 21, 1906 (34 Stat. L., 584, 590). As used in that Act, an "order for the payment of money" means, and is used synonymously with, "an award of damages under the provisions of this act for a violation thereof" (see Section 16, par. 1 and 2). No other orders for the payment of money were within the jurisdiction of the Commission at the time of the passage of the Transportation Act.

Orders of the Commission "other than for the payment of money" were then, as now, enforceable by mandatory injunction under Section 16(12), or by suits for recovery of penalties. Orders for the payment of money, on the other hand, were awards of damages, enforceable by suits at law brought by the party who had been complainant before the Commission; and it was provided that they should "proceed in all respects like other civil suits for damages" (Section 16(2)). So much of this order as required payment to the United States of the amount found to be held in trust, has no analogy to an "order for the payment of money," which is based upon an award of damages and which must be enforced by an action at law for the recovery of damages.

Furthermore, to interpret this order as an order for the payment of money is to give it an interpretation fatal

to the authority of the Commission to make and enforce it. Section 15a does not prescribe the method by which it is to be enforced. The power to make the order, and to enforce it, must be derived from Section 13, which authorizes the Commission to "make" and to "enforce" orders for "the enforcement of any of the provisions" of the Act, after hearing, upon investigations instituted on its own motion.[1] No power to make and enforce orders in an inquiry instituted on the Commission's own motion is conveyed by any other section of the Act. The power of the Commission, however, to act under Section 13, is expressly limited to the making and enforcing of "orders, excepting orders for the payment of money."

In proceeding to investigate the excess income of appellants, and to make the order involved in this case, the Commission evidently proceeded upon the theory that it had the power to do so under Section 13. If its order is an "order for the payment of money," it had no authority so to proceed.

Unless the order was one which the Commission was authorized to make in an investigation on its own motion

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[1] Section 13, paragraph (2), provides:

"* * * the Interstate Commerce Commission shall have full authority and power at any time to institute an inquiry, on its own motion, in any case and as to any matter or thing concerning which * * * any question may arise under any of the provisions of this Act, or relating to the enforcement of any of the provisions of this Act. And the said Commission shall have * * * the power to make and enforce any order or orders in the case, or relating to the matter or thing concerning which the inquiry is had *excepting orders for the payment of money.*"

under Section 13 (to wit, an order other than for the payment of money) it amounted to no more than a request for payment, (see *Brooklyn Eastern District Terminal* v. *United States*, 28 F. (2d) 634), to enforce which the Commission would be required to proceed by a suit in equity for a determination of the amount held in trust, and for a mandatory injunction for the creation of a reserve, in which all questions of fact would be primarily for the court.

Such an interpretation would be inconsistent with the whole theory of the Act, and would transfer from the Commission to the courts primary jurisdiction over the determination of value, income and every other question involved in such cases. To interpret this order as an "order for the payment of money," in addition to being inconsistent with the historical meaning of the words in the Interstate Commerce Act, and with the meaning which has always attached thereto, would be destructive both of the order itself and of the orderly administration and enforcement of the recapture provisions.

For the above reasons appellants respectfully submit that it is clear that this Court has jurisdiction over this appeal.

STATEMENT OF THE CASE.

1. The Statute.

The pertinent provisions of Section 15a are set out in full in the Appendix (*infra*, p. 180).

Briefly, this section requires (1) that the Commission shall so adjust rates that the carriers as a whole (or as a whole in each of such rate groups as the Commission may from time to time designate) will earn an annual net railway operating income equal, as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation; (2) that if any carrier *under the provisions of* said section, in any year receives a net railway operating income in excess of six per centum of the value of its railway property, it shall hold one-half thereof as trustee for, and shall pay it to the United States, and shall impound the remaining one-half of such excess in a reserve fund, until such fund shall equal five per centum of the value of its railway property; (3) that said fund shall not be drawn upon except for specific limited purposes enumerated; and (4) that a group of carriers which the Commission finds are under common control and management and are operated as a "single system," shall be treated as a unit in the ascertainment of value and income.

2. Report and Order of the Commission.

The Commission's order was made in proceedings instituted by the Commission on its own motion (R., 34-35) for the purpose of inquiring into the excess income, if

any, of the appellants, The St. Louis and O'Fallon Railway Company (hereinafter called the O'Fallon) and Manufacturers' Railway Company (hereinafter called the Manufacturers). Evidence was introduced by the Commission and the carriers (R., 290 *et seq.*) in respect of the value and income of each of the appellants for the last ten months of 1920 and for the calendar years 1921, 1922 and 1923, and as to whether, as claimed by the appellants, the two railways constituted a single system within the meaning of Section 15a. In its Report and Order[1] (R., 37-108) the Commission found and held:

> (1) That although the O'Fallon and Manufacturers constituted a group of carriers under common control and management, they were not "operated as a single system," within the meaning of the Act.
>
> (2) That the net railway operating income of the Manufacturers did not exceed six per centum of the value of its railway properties during any of the periods covered by the inquiry. No specific finding of the value of the Manufacturers, however, was made.
>
> (3) That the value of the property of the O'Fallon in each of the periods in question, to

[1]The full text of the order of the Commission is set out in the Appendix (p. 183). The Report and Order of the Commission, constituting "Exhibit B" to the petition filed in the District Court, as the same are contained in this Record (36-108), are photostatic copies of the original Report and Order, as published by the Commission, and include the paging that appears in the published decisions of the Commission, 124 I. C. C. 3.

wit, for the last ten months of 1920 and for each of the calendar years 1921, 1922 and 1923, was as found and determined by the Commission in said Report; that the net railway operating income of the O'Fallon exceeded, six per centum on the value of the property of that carrier as so found by the amounts stated in said report and order; that the O'Fallon held one-half of the excess in each period as Trustee for the United States; that it should pay the same to the Commission, for the United States, together with interest at six per centum per annum from May first of each year next following each recapture period, and that it should place the remaining one-half of such excess income in a reserve fund, as required by the statute.

3. The Contentions of the Appellants and the Grounds of Attack Upon the Order in This Court and in the Court Below.

The petition charges that the order of the Commission is void because (1) based on errors of law, (2) unsupported by the evidence and (3) in contravention of the Fifth Amendment (Par. 29, R., 28-30).

The specific grounds of attack upon the validity of the order both in this Court and in the Court below, among others, are:

(1) That the Commission's finding that, although the O'Fallon and Manufacturers constituted a group of carriers under common control and management, they were not operated as a single system, within the meaning of the Act, is based upon an erroneous interpretation of the statute and un-

supported by and contrary to the evidence, and that said railroads in fact, and as shown by the undisputed evidence before the Commission, constituted a group of carriers under common control and management and operated as a single system (Petition, par. 13, R., 10-18). If this contention is sustained, the order is clearly void, since it is based solely upon a consideration of the value and income of the O'Fallon alone. Furthermore, the Commission did not determine or undertake to determine the value of the property of the Manufacturers. Hence, there is no basis either in the Commission's report or in the record for a determination of the excess income of such system, if any, for an order directing either the creation of a reserve or payment to the United States, or for a decree modifying the order accordingly.

If the Court should sustain the appellants on this point, the whole order is void. It is nevertheless respectfully suggested that under these circumstances, the Court should also review the Commission's findings of value and pass upon the questions raised in connection therewith. The effect of setting the order aside on the ground that the Commission should have found that these two carriers constituted a single system will be to send the case back to the Commission to determine the value and income of such carriers as a single system. If it has erred in making its findings of value, that error should be corrected now. Furthermore, the public importance of the value questions is such that they should now be decided by this Court.

(2) That it appears upon the face of the Report that the Commission did not determine or undertake to determine the "present value" of the O'Fallon by a consideration of all relevant facts and circumstances, but that its so-called findings of value in respect of the O'Fallon were based upon a mathematical formula, the avowed purpose of which was to determine the approximate investment in its property; that the Commission refused in such so-called determination of value to give either effective weight or any weight whatsoever to the present cost of construction; that such refusal was not based upon any fact or facts found by the Commission pertaining to the property of said carrier, but upon the conclusion of the Commission, as stated in its Report, that no consideration should be given to present day prices in determining the value of any railway property within the United States for the purposes of either rate making or recapture; that the Commission's so-called findings of value are based upon an erroneous conception of the law and of its powers thereunder and are unsupported by and contrary to the evidence; and that the true value of the O'Fallon greatly exceeded the so-called values found (Petition, Par. 14-23, R., 18-24).

It is the contention of appellants that the Commission in its Report and Order disregarded and refused to follow the prior decisions of this Court declaratory of the law of the land, applicable to the valuation of public utility property, and substituted in lieu thereof the Commission's conception of what the law should be; that it did so upon considera-

tions of supposed economic expediency and for the purpose of challenging the soundness of the prior decisions of this Court (Report of the Commission, R., 51-78, hereinafter analyzed in detail).

Commissioners Hall, Aitchison, Woodlock and Taylor dissented upon the ground that it was the duty of the Commission to obey the law, not to make it (R., 93-103).

If the Commission's findings of value are based upon erroneous legal principle, or unsupported by and contrary to the evidence, as charged, the order of the Commission is manifestly void because in excess of the statutory authority conferred upon it.

(3) That under the provisions of the Act, all net railway operating income in excess of one-half of the amount by which such income exceeds six per centum of the value of the carrier's property remains the absolute property of the carrier, and consequently the order of the Commission, if it takes more, constitutes a taking of the carrier's property without due process of law, and a taking of private property for public use without just compensation.

(4) That the order of the Commission is void because the operation of the recapture provisions are dependent upon the prior establishment of rates in accordance with the rate-making provisions contained in paragraph (2); that unless and until rates are so established there may be no recapture; and that during none of the recapture periods had the rates of the carriers, in the regional rate group

in which the O'Fallon was located, been so adjusted (Petition, Par. 24, R., 24-26).

(5) That so much of the order as required the creation of a reserve fund in accordance with the Act is void because, if enforced, the reserve fund provisions of the Statute, by reason of the limitations placed upon the use of the carrier's money impounded thereby, deprives the carrier of its property without due process of law (Petition, Par. 27, R., 27).

(6) That the requirement that interest be paid from and after May first in each year succeeding the recapture period is void (Petition, Par. 28, R., 28).

4. The Action of the Court Below.

A majority of the court below, in an opinion by Judge Stone, concurred in by Judge Van Valkenburgh, held that it did not appear upon the face of the petition that the effect of the order was to deprive the O'Fallon of its property without due process of law. This conclusion rested on the ruling that if, as was held necessary, the amounts required to be placed in the reserve fund were added to the free income remaining to the carrier, the sum of the two together exceeded six per centum on the minimum value of the carrier's property as alleged in the petition (R., 128-131). In this appellants contend the Court below erred. Having reached this conclusion, the Court said that

> "the verity of the Commission's valuation herein need not be examined and cannot affect this recap-

ture order, and, therefore, that such order is not open to attack upon the ground of wrongful valuation. If this be true, it is unnecessary to examine and determine the various contentions made by the parties and *amici curiae* concerning the proper manner of ascertaining value herein" (R., 131-132).

In thus holding, the Court determined the issue of confiscation, not by deciding whether the amount taken was in excess of that authorized by the statute, but upon the sole consideration that the return remaining to the carrier exceeded six per cent. In this, appellants contend the Court erred. It is also their contention that having thus determined the constitutional question, the Court erred further in refusing to consider whether the Commission's order was in excess of its statutory authority by reason of the alleged invalidity of its findings of value. Judge Faris, in a separate opinion, concurred in the result upon the ground that the value of the O'Fallon had been properly determined by the Commission, but dissented from the view of the majority that it was unnecessary for the Court to pass upon the question of value (R., 140-148).

The Court annulled so much of the order as required the payment of interest from May first in each year succeeding the end of each recapture period (R., 139), and held that interest began to run ninety days after February 15, 1927, but held adversely as to all other contentions of the appellants (Opinion below, R., 125-140), and dismissed the appellants' petition in all other respects, adjudging the costs against the appellants (Final Decree, R., 148-149).

5. Cross-Appeal by Defendants Below.

A cross-appeal was taken by the defendants below from so much of the decree as annulled that part of the order relating to the payment of interest (R., 162).

6. Questions for Review in this Court.

All questions raised below are before this Court under the assignment of errors (R., 153-159). In addition, there is presented to this Court for determination the alleged error of the court below in refusing to pass upon the valuation issue. The appellants also contend that the Court erred in rejecting certain evidence offered by them, the nature of which will be described in the argument. This evidence, for the most part, was offered in support of the allegations of the petition that the true value of the property greatly exceeded that found by the Commission, and that the order resulted in confiscation. If, as charged in the petition, the order is void on its face because based upon erroneous principles of law, or because contrary to and unsupported by the evidence, the issue raised by the Court's rejection of this evidence becomes immaterial to the decision of the case.

SPECIFICATION OF ERRORS.

A specification of such of the assigned errors as appellants urge is that the court below erred[1]:

13: In dismissing the petition herein and in holding that the order of the Interstate Commerce Commission of February 15, 1927, as modified by the decree of the

[1]The Assignment of Errors are printed at R., 153-159.

court, was valid and enforceable, and in failing to annul said order and to enjoin its enforcement.

4-5: In holding that the said order, as enforced, will not deprive appellants of their property without due process of law, in contravention of the Fifth Amendment.

6-8: In holding that the correctness of the Commission's valuation of the O'Fallon, and of the manner in which such valuation was made, was not material to the validity of its said order; and in not holding that it was necessary, in order to determine the validity of the said order, to determine, by the exercise of the court's independent judgment on the evidence introduced, whether the true value of the property of the O'Fallon was substantially in excess of the value found by the Commission.

9: In not holding the said order of the Commission to be null and void and unenforceable, by reason of the failure of the Commission to find, consider, and give substantial weight to, the current cost of reproducing the property of the O'Fallon.

10-11: In not holding that it appeared both upon the face of the report and from the uncontradicted evidence before the Commission that the true value of the property of the O'Fallon as of the respective periods covered by the order, and each of them, was substantially in excess of the value found by the Commission in its said report.

12: In not holding that the said order of the Commission is void because unsupported by the evidence before the Commission.

13: In not holding that said order of the Commission is void because based upon erroneous principles of law.

14: In not holding that said order of the Commission is void because in determining the value of the property of the O'Fallon, upon which determination said order was based, the Commission failed and refused to give due consideration to all the elements of value recognized by the law of the land for rate-making purposes.

15: In not holding that the order of the Commission was void because in making the same the Commission gave consideration to matters not in evidence before it and to a considerable extent based its order upon such matters.

16: In not holding that the order of the Commission was void because in excess of the statutory authority conferred upon the Commission.

17: In not holding that the true value of the O'Fallon's property held for and used in the service of transportation, substantially exceeded the value found by the Commission upon which its order is based.

18: In not holding the said order to be null and void because the amounts directed to be paid to the United States thereunder exceeded one-half of the excess over six per cent. (6%) of the true value of the property of the O'Fallon held for and used in the service of transportation in the respective recapture years.

19-22: In holding that appellants, the O'Fallon and the Manufacturers', did not constitute a group of carriers

under common control and management and operated as a single system, and that the evidence before the Commission sustained the finding of the Commission that appellant did not constitute such a group of carriers; and in failing to hold the contrary.

23 27: In holding that the establishment of rates under Section 15a of the Interstate Commerce Act, as amended, is not a prerequisite to the recapture of excess earnings in said Section 15a; and in not finding and holding that during and for the periods ending respectively (1) December 31, 1920, (2) December 31, 1921, (3) December 31, 1922, and (4) December 31, 1923), the Commission had not, under said Section 15a, so established rates in the group in which the property of the O'Fallon had been placed by the Commission under said section, that the carriers therein had an annual net railway operating income equal as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation; and that by reason thereof, the provisions of said Section 15a governing the payment and distribution of excess earnings thereunder were inapplicable, and that the said order of the Commission, in respect of each of said periods, was null and void.

30 31: In not holding that the reserve fund provisions of paragraph (6) of said Section 15a are null and void, and will, if enforced, deprive the O'Fallon of its property without due process of law, in contravention of the Fifth Amendment; and that so much of said order as requires the establishment of a reserve fund by the O'Fallon is null and void.

32-33: In not holding that so much of said order as required the payment of excess earnings and the creation of a reserve fund out of earnings of the O'Fallon between March 1, 1920, and August 26, 1920, was null and void, and in excess of the statutory authority conferred upon the Commission.

34-36: In ruling that no evidence other than that offered before the Commission was admissible in court; in excluding evidence offered by appellants, tending to show the true value of their property held for and used in the service of transportation; and in not holding that it was necessary, in order to determine the validity of the said order, to determine, by the exercise of the court's independent judgment on the evidence introduced, and on the additional evidence offered by appellant, whether the true value of the property of the O'Fallon was substantially in excess of the value found by the Commission.

37-39: In holding that interest is payable on the respective amounts ordered to be paid to the Commission as recapturable by it, and that interest is payable beginning 90 days after the date of the Commission's order of February 15, 1927, and in not holding that no interest is recoverable for any period, prior to the date of the final decree.

40: In adjudging the costs in the District Court against the appellants.

ARGUMENT.

I.

THE COURT BELOW ERRED IN REFUSING TO REVIEW THE COMMISSION'S DETERMINATION OF THE VALUE OF THE PROPERTY OF THE O'FALLON.

1. Irrespective of any issue of confiscation, the appellants were entitled to a review of the Commission's finding of value, which were attacked for errors of law and because unsupported by and contrary to the evidence, and upon which its determination of the Carrier's excess income depended.

Section 15a, in paragraphs (5) and (6), provides that any carrier, which under rates established in accordance with the provisions of that section, earns a net railway operating income in any year in excess of six per cent. of the value of its railway property, shall hold one-half of such excess as trustee for, and shall pay it to, the United States. It declares no trust as to more, nor requires the payment of more. The remaining one-half remains the absolute property of the carrier except in so far as it may be required to be placed in a reserve fund up to an amount equal to five per cent. of the property value and held for restricted purposes. The order sought to be reviewed was made in the administration of this section of the Act. Under this section no ascertainment of the amount held in trust and no order directing that amount to be paid to the Commission, or directing any amount to be placed in the reserve fund, can be made without a determination of such value.

It is well settled that orders of the Commission will be set aside if based on mistake of law, or if contrary to or unsupported by the evidence, even though their effect is not so extreme as to violate constitutional rights.

Interstate Commerce Commission v. *Illinois Central R. R.*, 215 U. S. 452;

Interstate Commerce Commission v. *Union Pacific Company*, 222 U. S. 541;

United States v. *Abilene & Southern*, 265 U. S. 275;

Western Chemical Co. v. *U. S.*, 271 U. S. 268;

New England Division Case, 261 U. S. 204;

Interstate Commerce Commission v. *Northern Pacific Ry.*, 216 U. S. 538;

Interstate Commerce Commission v. *Louisville & Nashville Ry.*, 227 U. S. 88;

Pennsylvania Company v. *U. S.*, 236 U. S. 351, 361;

Brimstone Railroad Co., v. *U. S.*, 276 U. S. 104;

Louisville & Nashville Ry. Co. v. *Behlmer*, 175 U. S. 648;

Skinner & Eddy Corporation v. *U. S.*, 249 U. S. 557;

The Chicago Junction Case, 264 U. S. 258;

Illinois Central R. R. v. *U. S.*, 216 U. S. 538, 544;

U. S. v. *Baltimore & Ohio R. R. Co.*, 231 U. S. 274;

The Tap Line Cases, 234 U. S. 1;

Louisville Cement Co. v. *Interstate Commerce Commission*, 246 U. S. 638;

Interstate Commerce Commission v. *Delaware, Lackawanna & Western*, 220 U. S. 235;
Louisville & Nashville Ry. v. *U. S.*, 245 U. S. 463, 466;
Manufacturers' Ry. v. *U. S.*, 246 U. S. 457, 581.

The petition alleges that the Commission's determination of value was based upon an erroneous construction of the law (R., 16-24, 28, 29); that the value of the property was in excess of the value found by it (R., 24), and that the Commission's finding was contrary to and unsupported by the evidence before it (R., 29). As the petition alleges (R., 16-28), the foregoing appears on the face of the report, and also was shown by the evidence before the Commission (*infra*, pp. 49, 52, 55, 57, 63, 72, 101). Under these circumstances the court plainly erred in holding that it was unnecessary to inquire into these questions, or to review the Commission's findings or to determine whether the true value of the property exceeded what the Commission had found.

The order of the Commission depends absolutely upon its determination of value. Any enforcement of the recapture provisions requires, in the first instance, an ascertainment of value. Before an amount in excess of six per cent. of the value of the property, may be ascertained, the value itself must be ascertained. If the Commission did not ascertain the value, or if its finding of value is based upon errors of law, or is contrary to or unsupported by the evidence, the order should be enjoined. The majority below might as well have said that in making a lawful order it was unnecessary for the Commission to determine the value of the property,

as to say that it was unnecessary for the court to review the value which the Commission's report and order purports to place upon the property. Any fundamental defect in point of law in the Commission's finding of value necessarily vitiates the order.

2. The Court erroneously decided the issue of confiscation which was in fact presented by the petition and the proofs.

The Court below (Judge Faris dissenting), in determining whether the petition presented a confiscation issue, divided the net railway operating income of the carrier in each of the recapture periods into three parts: (1) The sum required by the order to be paid to the United States; (2) the sum required to be placed in the reserve; (3) the amount left to the carrier to be disposed of at its election for any lawful purpose. The petition alleged that the carrier's property during each of the recapture periods was worth *not less* than $1,350,000 (R., 24). Without any ascertainment of value by the Court, but erroneously interpreting the *minimum* value thus alleged as the maximum value susceptible of being found under the pleadings, the Court below found that the amount remaining in the possession of the carrier to be disposed of at its election for any corporate purpose, did not in any year exceed 4.35% of the assumed value of $1,350,000, a return which the Court found to be "obviously insufficient" (R., 129). The Court also found that if to the amount thus remaining at the free disposition of the carrier in each of the periods in question, there be added the amount directed to be placed in the reserve, which may be drawn upon only for the limited purposes authorized by the Act,

the sum of these two amounts ranged from 6.97% to 8.71% in the several recapture periods. Expressing no opinion of its own as to the propriety of including the reserve fund in the amounts by which the fair return was to be calculated, the Court felt found by a dictum of this Court in *Dayton-Goose Creek Railway Company* v. *United States*, 263 U. S. 456, 486, to add the amount of the reserve to the amount remaining under the free control of the carrier, and it being so included it was held that the return to the carrier was fair, and that therefore the order did not result in confiscation.

(a) MONEYS REQUIRED FOR THE RESERVE FUND WERE ERRONEOUSLY CONSIDERED AS THE CARRIER'S FREE INCOME BY THE LOWER COURT IN REACHING ITS CONCLUSION THAT CONFISCATION WAS NOT EFFECTED. BUT FOR THIS ERROR THE COURT MUST HAVE FOUND CONFISCATION, IF IT HAD HELD THE VALUE OF THE PROPERTY TO BE AS ALLEGED, AN ISSUE WHICH IT LEFT UNDECIDED.

The Court recognized that the treatment of the reserve fund was of decisive importance. It said (italics ours):

> "Therefore, it is of *controlling* importance, as to this contention in this case, to determine two matters. First, whether the return to the carrier in a recapture case is to be measured by the net revenue remaining after deducting both the amount to be paid over to the Government *and the amount to be placed in the 'reserve fund'* or is to be measured by the net revenue remaining after deducting *only* the amount to be paid over to the Government" (R., 129-130).

Paragraph (7) limits the use of the reserve fund as follows:

> "For the purpose of paying dividends or interest on its stocks, bonds or other securities, or rent for leased roads, a carrier may draw from the reserve fund established and maintained by it under the provisions of this section to the extent that its net railway operating income for any year is less than a sum equal to 6 per centum of the value of the railway property held for and used by it in the service of transportation, determined as provided in paragraph (6); but such fund shall not be drawn upon for any other purpose."

It is obvious from these provisions that the fund is not free. While it *may* ultimately be used for *certain* of a carrier's corporate purposes, such use is contingent upon a future inadequacy of income, which may not occur. The present use of this money is therefore impaired. As to all lawful uses except the few enumerated both present and future use is denied. It is really no part of the carrier's *present* return. Under certain conditions in the future it may become so for some limited purposes. Consequently, it should not have been regarded as part of the carrier's free income in determining whether its return was above the level of confiscation.

Property need not be wholly taken in order that there be a confiscation. A substantial infringement of the use of property, even though partial, is a taking which conflicts with constitutional safeguards. The Constitution protects the owner of property in its free use and this requires that, in considering whether the income thereof is a fair return, only the free income can be considered.

In the instant case, part, only, of the carrier's revenues were impressed with this limitation. Had *all* the revenue been so restricted, we doubt if it would even be claimed that a confiscation did not result.

The Court gave this question no independent consideration. It regarded itself as bound by a dictum from the decision in *Dayton-Goose Creek Railway* v. *United States, supra*, at page 486. The following statement from that decision is quoted in italics by the two Circuit Judges (R., 130):

> "Here we are relieved from considering the line between a fair return and confiscation, because under the provisions of the act and the reports made by the appellant, the return which it will receive after paying one-half the excess to the Commission will be about eight per cent. on the reported value. This can hardly be called confiscatory."

Regarding this language, the majority in the lower Court said (R., 130-131) (italics ours):

> "While the Court said that the issue of confiscation was not raised in that bill and that such issue 'cannot properly be said to be before us,' and, therefore, the above italicized expression may be regarded as a dictum not necessary to a decision of the case, yet we cannot say that it does not represent the view of that court as to that matter. *Whatever might be our independent view as to the inclusion of the 'reserve fund' portion with the net revenue left unrestricted with the carrier and the determination that such combined sum is to be taken as the 'return' by which confiscation is to be measured, we do not feel free to disregard this*

> ***seemingly clear and deliberate statement that such combined sum is such measure.*** Because that is the supreme and the only measure so far given by the Supreme Court in a recapture case, we feel obligated to accept it as the rule of law to be applied by us herein."

The majority apparently recognized that this was an unsatisfactory basis for the holding. The issue was *not* before the Court in the *Dayton-Goose Creek* case, and the Chief Justice so stated. The dictum relied on makes no reference to the reserve fund. It was a general statement, leading to a discussion of other matters which were before the Court. Manifestly it was not intended to foreclose the question now under review and which was not before the Court in that case.

Judge Faris in his separate opinion dissents on the point. He says:

> "I am unable to avoid the conclusion that the restrictions put by Section 15a of the Transportation Act on the use of that one-half of the surplus of annual earnings above 6 per cent., which is left in the carrier's hands, is at least a form of confiscation. * * * I am of the view that this court cannot avoid the necessity of meeting the question of legal methods of valuation, *vel non*, face to face. * * * I am constrained to the view that what was said in the case of *Dayton-Goose Creek Railway v. United States*, 263 U. S. l. c., 486, was *obiter dictum*, and clearly meant to be so, by the distinguished and learned writer of that opinion. Moreover, in the *Dayton-Goose Creek* case the correctness of the valuation was not attacked, but at least tacitly conceded" (R., 143-144).

This point alone is sufficient to show that the Court erred in holding that no constitutional issue was involved, and in refusing to pass upon the valuation issues presented. As the Court said in the majority opinion, in language which has been here quoted, the inclusion of these reserve fund moneys in the free income of the carrier is of "controlling importance," in that otherwise a confiscation must be regarded as effected, since the return was then "obviously insufficient" (R., 129).

(b) THE COURT ERRED IN ITS CALCULATIONS OF THE RATE OF RETURN BY ASSUMING THE MINIMUM VALUE ALLEGED IN THE PETITION TO BE THE MAXIMUM PROVABLE VALUE OF THE CARRIER'S PROPERTY IN EACH OF THE RECAPTURE PERIODS.

The petition alleged that during each of the recapture periods the actual value of the property of the O'Fallon greatly exceeded the value found by the Commission and was not less than $1,350,000 (R., 24). This is an allegation of minimum, not of maximum value. Under it, it was competent for the carrier to prove any value, either higher or lower than the figure named (*cf. Prendergast v. New York Telephone Co.*, 262 U. S. 43). The manifest purpose of alleging a specific sum was to establish on the face of the petition such a substantial difference between the *minimum* value claimed by the carrier in any of the years in question and the value placed upon the carrier's property by the Commission, as to show that it had been seriously injured by the order.[1] In taking this alleged *minimum* value to be the maximum value susceptible of

[1]The highest value placed upon the carrier's property by the Commission in any of the recapture periods was $978,874 (R., 77).

being found for any of the recapture periods, the Court fell into error. The value claimed by the carrier in the proceedings before the Commission for each of the recapture periods was greatly in excess of the minimum value stated in this paragraph of the petition (R., 68).

(c) THE COURT ERRED IN NOT HOLDING, THAT IF THE AMOUNT ORDERED PAID TO THE GOVERNMENT EXCEEDED THAT AUTHORIZED BY THE STATUTE, THE ORDER DEPRIVED THE CARRIER OF PROPERTY WITHOUT DUE PROCESS OF LAW.

In paragraph (5) it is provided that any carrier which receives an income in excess of six per cent. of the value of its property "shall hold *such part* of the excess, as *hereinafter prescribed*, as trustee for, and shall pay it to the United States." "Such part of the excess, as hereinafter prescribed", does not mean *all* of the excess. The phrase "as hereinafter prescribed" refers to the language of paragraph (6) which requires that only "the remaining *one-half* thereof shall * * * be recoverable by and paid to the Commission * * *." It will be noted, therefore, that of the income in excess of six per cent. of the value, properly determined, one-half *only* is held in trust for the Government. The remainder is the sole property of the carrier.

In the Court below the Government contended that the carrier held all of the excess as trustee for the United States. This contention is directly contrary to the express terms of the statute. In making it the Government relied on a dictum in *Dayton-Goose Creek Railway v. United States*, *supra*, in which this Court said (at p. 484):

> "The statute declares the carrier to be only a trustee for the excess over a fair return received by it. Though in its possession, the excess never becomes its property, and it accepts custody of the product and of the rates with this understanding It is clear, therefore, that the carrier never has such a title to the excess as to render the recapture of it by the Government or taking without due process."

This quotation was a part of the Court's answer to the contention that all of the carrier's income was its own property and that hence the statute was unconstitutional in that it sought to deprive the carrier of any of such property. Manifestly, it was an expression used for brevity in explaining the legal basis of the validity of the recapture scheme. It cannot be regarded as decisive of the question now under review, which was not before the Court or necessary to its decision. Under the plain language of the statute only one-half is held in trust, and the Court could not have intended to rule otherwise. As further evidence that all of the excess is not held in trust, it is significant that after a reserve fund equivalent to five per cent. of the value of the carrier's property has been accumulated out of the one-half of the excess to be devoted thereto, all of such one-half remaining becomes available to the carrier for any purpose.

Any order of the Commission requiring the payment of more than the amount held in trust under the terms of the statute works a deprivation of income not affected by the statute, but which vested in the carrier, and therefore constitutes a taking of the carrier's private property without due process of law. Such was the view of Judge

Faris, expressed in his concurring opinion as follows (R., 142-143).

> "For example, six per cent. of $1,350,000.00 is $81,052.44; the net operating income for the year 1922 was $165,123.47. Subtract from such income the $81,052.44, which plaintiffs contend the O'Fallon is entitled to, and there is left the sum of $84,071.08, only, subject to treatment for recapture purposes; one-half of which is $42,036.00, in round numbers; yet the Commission seeks to take $53,195. In my opinion there thus appears a clear confiscation of some $11,000.00; provided, the methods of valuation used by the Commission were not in accord with the rules and elements which serve to make up the law of the land. Since the matter of rate-making is not involved, I think the question is not one as to what money O'Fallon was allowed to keep, but one of what money was taken away from it. And this condition exists, regardless of whether the burdens and restrictions put upon the moiety of $42,036.00 left in O'Fallon's hands constitute confiscation of that money or not."
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> . . . . . .
>
> "The question here, I repeat, is one of valuation for recapture-of-profits purposes and not one of valuation for rate-making purpose. The matter of valuation for rate-making purposes is involved incidentally and in a way adventitiously only."

The majority in the Court below confused two types of cases which are entirely distinct from each other and in which the relation of value to the order under review is entirely different in its legal significance. In a confiscatory *rate case*, a Commission is limited only by the rule that the earnings resulting from the rates established must not

be so low as to yield less than a fair return on the value of the property. In such a case the confiscation is indirect. No property actually in the possession of and already belonging to the carrier has been directly taken. What it has been deprived of, is the use and enjoyment of its plant so as to yield a fair return on its value. If the rates established yield such a fair return, there has been no confiscation. On the other hand, as pointed out by Judge Faris, the relation of value to an order in a *recapture case* is entirely different. In such a case value is not ascertained for the purpose of determining what sum represents a fair return upon such value but for the purpose of drawing the boundary line which will determine what portion of the moneys in the possession of the carrier are its own sole property and what portion it holds as trustee for the United States. That which it holds as trustee for the United States it must pay over. That part which it does not hold as such trustee is its own property, of which it may not be deprived without due process of law, and its title thereto does not depend upon and has no relation whatever to its rate of return after recapture of the amount taken.

The recapture provisions were sustained as a regulation of commerce upon the theory that it was competent for Congress, as a part of the rule of rate making established by it, to declare that out of the net earnings received from such rates any carrier earning more than six per cent. on the value of its property should hold one-half of such excess as trustee for the United States, and that the amount *so declared to be held in trust* never became the property of the carrier.

If, as originally enacted, Section 15a had not contained the recapture clause, it would not be seriously contended that Congress, by a retroactive law, could subsequently require a carrier to pay over any part of the earnings derived from the rates established, irrespective of the rate of return remaining to the carrier after such appropriation. Such a statute would clearly deprive the railroad company of its property without due process of law irrespective of such remaining rate of return. Within the scope of its delegated powers, the Commission's orders have the force and effect of a statute. If Congress, itself, having recognized in Section 15a the property right of this carrier in one-half of the excess over six per cent., had, by direct legislative enactment, provided thereafter that it should pay to the United States, out of its income for the year 1922, *all* of the excess over six per cent., such action would manifestly deprive the carrier of its property without due process of law. So would a direct statutory enactment requiring the carrier to pay any other sum in excess of that held in trust. So is the order of this Commission requiring this carrier to do so, if it be true that the amount directed to be paid does in fact exceed one-half of the excess over six per cent. on the value. The question of value thus becomes important in this case for the purpose of determining what moneys in the possession of the carrier are its own, and what are held by it in trust.

The situation is analogous to one in which a taxing agency exceeds its authority. Courts, unless prohibited by statute, will enjoin taxes not levied in accordance with law, on the ground of a confiscation or taking of property without due process. Taxes levied through errors of

law against the wrong owner, on property outside the territorial jurisdiction, at an erroneous rate, or on any other basis erroneous in point of law, will be so enjoined. Had a taxing Commission increased an assessment required by statute to be on the basis of the *value* of the property, by calculating the assessment on the prudent investment in the property, or some other basis inconsistent with and higher than that prescribed by the statute, the tax would be enjoined as a matter of course, as a taking of property without due process.

In *Board of Directors* v. *Pipe Line Company*, 292 Fed. (8th C. C. A.) 474 (certiorari denied 263 U. S. 718), the taxing board appeared to have found the value of the property subject to taxation in accordance with a method not specifically authorized by the statute. The Court held that, if the method pursued was authorized by the statute, the statute itself "amounted to the taking of defendants property in violation of the Fourteenth Amendment, and then said:

> "If the method pursued by the board in fixing the valuation was not in accordance with the statute, then it was palpably arbitrary, and a plain abuse and violative of the Fourteenth Amendment" (p. 479).

In *Myles Salt Co.* v. *Iberia Drainage District*, 239 U. S. 478, it was charged that the action of the taxing authorities violated the due process clause of the Fourteenth Amendment. The case was here on writ of error. Motion to dismiss was made upon the ground that no Federal question was involved since the statute itself was not attacked, but

only its administration by the taxing authorities. The Court overruling the motion said:

> "We cannot concur in the contention. It is true the law of the State as written is not attacked, but the law as administered and justified by the Supreme Court of the State is attacked and it is asserted to be a violation of the Constitution of the United States. The question presented is Federal and the motion to dismiss is denied. And the considerations that move a denial of the motion move a decision of the merits of the question" (p. 484).

See also *Louisville and Nashville* v. *Greene*, 244 U. S. 522.

If, therefore, the amount required by the order to be paid is greater than one-half of the excess over six per cent. on the value of the property, the order is void because it operates to deprive the carrier of its property without due process of law as well as because in excess of the Commission's statutory authority.

3. Section 15a, if construed according to the theory enunciated by the lower court, is an improper delegation of arbitrary power to the Commission, and both the statute and the order made thereunder are therefore void.

The position of the lower court, in effect, is that earnings may be recaptured on any basis the Commission may happen to fix, provided only that the carrier's retained earnings are equal to a fair return on its true value. Under the statute thus interpreted, the Commission, in the administration of the statute, is without any guide or standard, as a consequence of which a power of

arbitrary action is delegated to it. As thus interpreted the Commission need not determine the value of the property of any carrier suspected of being subject to recapture. An order based upon any sum may be made, so long as the amount remaining constitutes a fair return on the true value of the carrier's property, as subsequently determined by the Court in a suit in which the order is attacked, although such value may exceed the arbitrary sum on which the order is predicated.

To illustrate: had the Commission concluded that the recapture base of the O'Fallon property in 1921 was zero, all of the income of that year, $182,726, would have been excess earnings. The carrier would then have been entitled to retain one-half of that sum or $91,363, which is 6.67% of the carrier's claimed minimum value of $1,350,000. Under the theory of the lower court, no issue of confiscation would be present, as the carrier would retain not less than a fair return, (assumed to be 6 per cent.). In any case where a carrier is earning in excess of twelve per cent. of its fair value, the lower court would not upset an order of the Commission even if the recapture base was zero, because the one-half of the excess earnings retained by the carrier exceeds six per cent. of the actual value. On the other hand, in any case of a railroad earning in excess of six per cent. but less than twelve per cent., under the theory of the lower court the Commission's rate base, to be safe against judicial review, need only be sufficiently high that a six per cent. return thereon, when added to the one-half of the excess earnings retained by the carrier, will together produce a sum constituting six per cent. on the actual value. For example, if the actual value was admittedly $100,000, and the net

income $8,000, the lower court would not upset an order of the Commission finding a value of $68,000, assuming 6 per cent. to be a fair return.

Thus, under the theory of the lower court, the Commission's administration of the statute will result in the rights of the railroads being determined by standards that will vary according to the arbitrary conclusions of the Commission, not according to the actual values. Had the statute as passed contained such a provision of inequality, it would have been directly and clearly in violation of the constitution. As interpreted by the lower court, the statute is similarly unconstitutional. The statute, thus interpreted, leads to "such a gross and patent inequality" as amounts to a taking of property in violation of the Fifth Amendment. *Brushaber* v. *Union Pacific R. R. Co.*, 240 U. S. 1, 24; *Tonawanda* v. *Lyon*, 181 U. S. 389, 392; *Cass Farming Co.* v. *Detroit*, 181 U. S. 396; *Leeper* v. *Texas*, 139 U. S. 462, 468.

4. The appellants were entitled to the independent judgment of the Court on the question of value.

For the reasons stated (*supra*, p. 32 *et seq.*), the bill tendered the issue of confiscation. Whether the order deprived the carrier of its property without due process of law, in turn depended upon a determination of the value of the carrier's property. This being so, the O'Fallon was entitled to the independent judgment of the Court as to both the law and the facts. *Ohio Valley Water Co.* v. *Ben Avon Borough*, 253 U. S. 287; *Bluefield* v. *Public Service Commission*, 262 U. S. 679. Without such a judicial determination, by the exercise of the independent judgment

of the Court, the carrier has not had its day in court. As stated in *Ohio Valley Water Co.* v. *Ben Avon Borough, supra,* p. 298, there must be provided "a fair opportunity for submitting that issue (that is, the issue of confiscation) to a judicial tribunal for determination upon its own judgment as to both the law and the facts," this being a jurisdiction which "must be plainly entrusted to some Court in order that there may be due process of law."

II.

IT WAS THE DUTY OF THE COMMISSION TO FIND THE PRESENT VALUE OF THE PROPERTY OF THE O'FALLON IN ACCORDANCE WITH THE DECISIONS OF THIS COURT.

By the express terms of the statute excess net operating income arises only when it is in excess of six per cent. on the "value" of the property. Without further definition, it would have been the duty of the Commission to determine such value in accordance with the applicable law as declared by this Court.

Congress, however, in the Act itself has defined what it meant by "value." The recapture clause (Sec. 15a, paragraph 6) provides that in recapture cases the value of a carrier's property shall be determined by the Commission in the manner provided in paragraph 4, which prescribes that in determining value the Commission "shall give due consideration to all the elements of value recognized by the law of the land for rate making purposes." The law of the land as declared by this Court had become crystallized and firmly established long prior to the Transportation Act. Subsequent decisions of the Court are merely confirmatory of the law as it existed when that law was passed. Congress itself, therefore, defined the word "value" in terms of existing law and by familiar rules of statutory construction the law as thus defined and declared prior to the adoption of the statute must be read into it. The duty of the Commission to determine such value in accordance with the decisions of this Court is plain.

III.

THE REPORT OF THE COMMISSION, INSTEAD OF FOLLOWING THE DECISIONS OF THIS COURT IN DETERMINING VALUE, CONSTITUTES A DIRECT AND DELIBERATE CHALLENGE THERETO.

The attitude of the majority toward the law and the prior decisions of this Court appears to have been that expressed by Commissioner Eastman in his concurring opinion and was that, as to matters determinative of the principles of law which should govern the valuation of public utility property, the Commission

> "occupies a daily front seat upon the stage, while the Supreme Court of necessity is only an occasional visitor in the balcony" (R., 85).

Commissioner Hall, with whom Commissioners Aitchison, Woodlock and Taylor concurred, dissented upon the ground that it was the duty of the Commission to obey the law and not to make it, and that it had substituted its own conception of what the law ought to be for what it is (R., 93-103).

That it did so and that its report is a direct and deliberate challenge of the prior decisions of this Court appears plainly on the face of the report. This Court has repeatedly held that present value is not synonymous with original cost, nor is it a matter of mathematical formula, but must be determined by a consideration of all relevant facts and circumstances. *Smyth* v. *Ames*, 169 U. S. 466; *San Diego Land & Town Co.* v. *Jasper*, 189 U. S. 439; *Wilcox* v. *Consolidated Gas Co.*, 212 U. S. 19;

Minnesota Rate Cases, 230 U. S. 352; *San Joaquin Co.* v. *Stanislaus County*, 233 U. S. 454; *Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U. S. 276; *Bluefield Water Works & Improvement Co.* v. *Public Service Commission*, 262 U. S. 679; *Georgia R. & Power Co.* v. *Railroad Commission*, 262 U. S. 265; *McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400.

Instead of undertaking to determine the present value of the carrier's property in accordance with these decisions, the Commission's findings of value are based on a mathematical formula, the primary purpose of which was to determine the amount of investment in the carrier's property (*infra*, Chap. IV, pp. 52, 55).

Under the prior decisions of this Court cost of reproduction at current prices is a relevant fact to be considered. This Court has never held that value and cost of reproduction, less depreciation, if any, are synonymous. Appellants do not so contend. So to hold would be to substitute another mathematical formula for that employed by the Commission. It is, however, a relevant fact to which due consideration must be given. In the majority of cases decided by this Court it is of all relevant facts that which has been accorded the greatest weight. In rejecting it, as a relevant fact entitled to no consideration whatsoever, as it did (*infra*, p. 61; Chap. IV, pp. 52, 55; p. 60), the Commission failed to follow the prior decisions of this Court. If, on the contrary, it had determined the value of this property by a consideration of all relevant facts and circumstances, including as one its cost of reproduction at current prices, the value found must have been substantially higher (*infra*, p. 63).

The major portion of the carrier's property was valued at an amount assumed to represent the approximate investment therein, in the absence of reliable information as to original cost. The order was thus predicated upon the assumption that such approximate investment could be determined by use of the formula employed. This assumption was wholly without any support whatever in the record (*infra*, p. 101). On the contrary, as will hereafter appear, approximate investment could not be ascertained by the use of such formula (*infra*, p. 103). The Commission's determination of approximate investment was therefore as arbitrary and artificial as its determination of value (*infra*, p. 107).

The accuracy of the foregoing characterization of the Commission's findings of value cannot be doubted, as will subsequently appear. The Commission thus substituted for the flexible and rational rule of *Smyth* v. *Ames*, under which value is a matter of judgment to be determined by a consideration of all relevant facts and circumstances, an arbitrary standard of its own based on no relevant facts and in complete and deliberate disregard of the prior decisions of this Court.

IV.

THE ORDER IS VOID FOR ERRORS OF LAW BECAUSE THE COMMISSION'S FINDINGS OF SO-CALLED VALUE WERE DETERMINED BY THE USE OF A MATHEMATICAL FORMULA, THE AVOWED PURPOSE OF WHICH WAS TO DETERMINE THE APPROXIMATE INVESTMENT IN THE PROPERTY AS DISTINGUISHED FROM ITS PRESENT VALUE.

1. Summary statement of the method pursued by the Commission.

"Value" for each of the recapture periods was determined by adding the actual cost of additions since June 30, 1919, to a so-called single sum basic valuation as of that date of $850,500 (R., 42-43). The Commission had not at the time determined the value of the carrier's property under the valuation provisions (Sec. 19a) of the Act. An investigation was in progress under Sec. 19a to determine the value of the carrier's property as of June 30, 1919. The so-called single sum basic valuation was therefore made as of that date in order to utilize the results of such investigation, including the inventory of the property taken as of that date (R. 53). Beyond this, there is nothing which makes this date significant.

This single sum valuation includes $50,500 as the present value of lands and $50,000 as an allowance for working capital (R., 65, 76). The remainder, $750,000, represents the valuation placed by the Commission upon the remainder of the carrier's property as of June 30, 1919 (R., 65). The valuation of this part of the carrier's

property was determined by applying unit prices representing costs in and for a few years prior to June 30, 1914 (called 1914 prices, R., 55), to the 1919 inventory, and by deducting therefrom depreciation computed on the straight line method. To cost of reproduction less depreciation, thus determined ($678,506), there was added $38,843.12, found to be the amount by which the actual cost of units of property installed between July 1, 1914, and June 30, 1919 (and therefore included in the 1919 inventory) exceeded their estimated cost of reproduction at 1914 prices at which they were included in reproduction items. The purpose of this was to include within the 1919 value, the actual cost of these units (R., 56-57). There were then added the allowances for lands and working capital ($100,500) and the further sum of $32,660.88, producing the valuation of $850,500[1] placed upon all of the carrier's property as of June 30, 1919 (R., 73-4).

The purpose of the addition of $32,660.88 is disclosed by the Report. It was apparently intended to cover appreciation, going concern and other intangible elements of value, as to which the Commission has said it was impossible to ascribe a definite figure, *Texas Midland R. R.*, 75 I. C. C. 1; *Winston-Salem Southbound Ry Co.*, 75 I. C. C. 187, 195; *San Pedro, Los Angeles & Salt Lake*

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[1]Single sum basic valuation $850,500.00

Cost of reproduction less depreciation at 1914 prices	$678,506.00	
Addition for actual cost July 1, 1914—June 30, 1919 in excess of reproduction at 1914 prices	38,843.12	
Lands	50,500.00	
Working capital	50,000.00	817,849.12
Additional allowance		$ 32,660.88

R.R. Co., 75 I. C. C. 463, 509.[1] That such was its purpose is also indicated by the context. It can not be contended that this sum was intended in any degree to cover the enhanced cost of labor and materials during the recapture periods over those of 1914. Any such contention, if made, is fully refuted by the Commission's own declaration (R., 73) that such enhanced prices are reflected in the valuations found *only* to the extent that they are reflected in the actual *cost of property acquired and installed at such prices*, i. e., when included in the investment in the property.

The major portion of the carrier's property in each of the recapture years consisted of property other than lands and working capital in existence and use on June 30, 1914. The value of all such property was determined on the basis of its cost of reproduction less depreciation at the obsolete pre-war prices of 1914.

The value of the property in each of the recapture periods was thus determined by the following mathematical formula:

> (1) Find cost of reproduction less depreciation, as of June 30, 1919, of all property exclusive of lands and working capital at 1914 or pre-war prices.
>
> (2) Add thereto the amount by which the actual cost of the property installed between July 1, 1914,

[1] As explained in the Report (R. 71), the Commission, in determining the 1919 valuation, followed the methods pursued in valuations made under Sec. 19a, as described in *Texas Midland R. R., supra*. Similar allowances approximating, as in this case, five per cent., have been uniformly included in valuations found by the Commission under that section (Dissenting Opinion of Commissioner Potter, *Florida East Coast Ry. Co.*, 84 I. C. C. 25, 41).

and June 30, 1919, exceeded its cost of reproduction at 1914 prices.

(3) Add allowance for land at present value.

(4) Add to the sum of the foregoing the further sum of $32,660.88, presumably for intangibles, an amount equivalent to about 5%.

(5) Add allowance for working capital.

(6) Add for each of the recapture periods the actual investment in additions and betterments, less retirements, subsequent to June 30, 1919.

As shown in the Report, this method of determining the value of the carrier's property was pursued for the purpose of determining the approximate investment therein, in the absence of accurate information as to original cost, which could not be found (R., 54).

2. It expressly appears on the face of the Report that the Commission's primary purpose was to determine investment instead of value.

The Commission's finding of $850,500 as the value of the carrier's property as of June 30, 1919, is stated at the bottom of page 40 of the Report (R., 74). As appears from the paragraph immediately preceding the finding, it is somewhat less than five per cent. in excess of the sum of (1) the cost of reproduction less depreciation of its structural elements at 1914 prices; (2) the amount by which the actual cost of units of property included within the 1919 inventory exceeded their estimated cost of reproduction at 1914 prices; and (3) the allowance for land. The working capital is then added (R., 73-74). As likewise

appears, the largest single factor in the sum thus produced was cost of reproduction less depreciation of the structural elements of the property at 1914 prices, to wit, $678,506 (R., 73-74). The Commission's own description of the component parts of its single sum basic valuation of June 30, 1919, thus corresponds to that described in the foregoing analysis of the Report as a whole.

Immediately following this finding of value as of June 30, 1919, and after indulging in some criticism of the cost of reproduction method, the Commission makes the following statement in justification of the method pursued in determining the basic valuation of June 30, 1919, and explanatory of its purpose (R., 75-76):

> "Value rests upon a number of elements. *The value of the property of railroads for rate-making purposes, which is construed to be the value of property devoted to common-carrier purposes upon which common carriers are entitled under the law to earn a fair return, approaches more nearly the reasonable and necessary investment in the property than the cost of reproducing it at a particular time.* In those cases, of which there are many and of which the present case is an example, *where it is impossible to ascertain and analyze the actual investment, resort must be had to the application, to complete property inventories, of unit prices derived from actual costs paid by carriers over a considerable period of years when railroad construction was being carried on extensively.*
>
> "The line of railroad of the O'Fallon, approximately 9 miles in length, was constructed in the years from 1896 to 1900, both inclusive. *While a satisfactory statement of the carrier's actual investment, or of the original cost of its property, is not*

available, much thought and effort have been devoted by us in our valuation work to determine the costs of building railroads during the years immediately following the period when this carrier's property was being built. The results of that study are reflected in the unit prices, which are herein termed 1914 unit prices, used in making the reproduction cost estimates of this property. With regard to the reliability of these unit prices for use in approximating the probable, reasonable, and necessary costs of constructing railroad properties built prior to June 30, 1914, we stated in *Texas Midland Railroad, supra*, at page 140, the following:

> 'While the commission is not as well informed today as it hopes to be before the end of its work, we are prepared to state with considerable confidence that *the cost of producing and equipping a railroad in most parts of this country on June 30, 1914, was a fair average for at least the 20 years preceding.* There had been many changes during that period. Some prices had advanced while others had declined. The cost of labor had somewhat increased, but improved methods tended to offset this increase. On the whole, the 1914 cost was just about an average for those previous years during which the great bulk of the railroad property then in use had come into existence.'" (Italics ours.)

Having thus determined that it ought to find "the reasonable and necessary investment in the property" and that for this purpose, in the absence of reliable information concerning investment or original cost, "resort" must be had to the substitution of 1914 prices for actual original cost, and having by this method and with this pur-

pose determined the 1919 valuation, the Commission then goes on to state the method by which the value of the carrier's property in each of the recapture years has been determined and the results of such determination as follows (R., 76-77):

> "*The method which we therefore find logical and proper for determining the value in the subsequent recapture periods is to add to or subtract from the 1919 value the net increases or decreases in the investment in property* devoted to transportation service as determined from the carrier's returns to valuation order No. 3, with due regard to the element of depreciation.
>
> "Applying this method the value for the purposes of this proceeding of the property which the O'Fallon was devoting to the service of the public during the 10 months ended December 31, 1920, was $856,065. This amount is composed of the sum of $850,500, which includes $50,500, the value of the common-carrier land, and the amount of $50,000 to cover the amount of the carrier's necessary investment in a stock of materials and supplies needed as working capital in carrying on its common-carrier operations during that period, and further the sum of $4,133, which has been found to be the net cost of additions and betterments less retirements during the period from July 1, 1919, to February 29, 1920, and the amount of $1,432 heretofore shown to be the average net cost of property added during the 10 months, March to December, inclusive, 1920.
>
> "This method produces for the calendar year 1921 as the value of the property devoted by the carrier to common-carrier service, for the purpose of this proceeding, $875,360. This amount is composed of the sum of $856,065, the value for the 10

months ended December 31, 1920, plus $9,327, which is the difference between the average net costs of property added during these 10 months and the total amount thereof which remained as an investment in the property on December 31, 1920, and plus the amount of $9,968 heretofore shown to be the average net cost of property added during the year 1921.

"By the same method the value of the property, for purposes of this proceeding, for the year 1922 was $978,874, and for the year 1923 was $978,246." (Italics ours.)

The Commission calculated the amount of excess income (R., 77-78) and predicated its order, upon the basis of valuations thus determined.

V.

THE ORDER IS VOID FOR ERRORS OF LAW BECAUSE, AS APPEARS ON THE FACE OF THE REPORT, THE ONLY CONSIDERATION GIVEN TO THE PRESENT ENHANCED COST OF LABOR AND MATERIALS IN DETERMINING THE VALUE OF THE MAJOR PORTION OF THE CARRIER'S PROPERTY WAS TO REJECT IT AS A RELEVANT FACT CONTRARY TO THE PRIOR DECISIONS OF THIS COURT.

1. The effect of the formula employed was to determine the value of the major portion of the carrier's property in each of the recapture years on the basis of obsolete pre-war prices.

In the dissenting opinion by Commissioner Hall (concurred in by Commissioners Aitchison, Woodlock and Taylor) the minority thus aptly and accurately described the method of valuation pursued by the majority, and its effect (R., 94):

> "Without summarizing the other processes, all clearly stated in the majority report, it will be observed that the rate-making value arrived at for the successive recapture periods, as for example the year 1923, rests upon 1923 market value of lands; costs of other property installed since June 30, 1919; unit prices of 1914, enhanced by allowance for increased cost of units installed during June 30, 1914-1919; and, for the units installed prior to June 30, 1914, constituting by far the major part of the property, unit prices of 1914 without any enhancement whatever. As to this major part of the carrier's property devoted to carrier purposes in 1923 no consideration is given to costs and prices then obtaining or to increase therein since 1914."

The method thus described conforms to the method disclosed by the foregoing analysis of the Report as a whole and as described in the majority opinion. There is, therefore, no dispute as to what the Commission did. Neither can there be any dispute that, in pursuing this method, the Commission was endeavoring to arrive at the approximate investment in the property, in the absence of reliable information as to original cost.

2. The only consideration given to enhanced costs of labor and materials in determining the value of the major portion of carrier's property was to reject it as a relevant fact entitled to any consideration whatever.

The Commission said (R., 65):

> "As hereinafter indicated, we arrive at a basic single-sum value as of June 30, 1919, of $850,500. This figure includes $50,500 for lands and $50,000 for working capital. The value exclusive of land and working capital is $750,000. Using the latter figure as a base merely for purposes of comparison and applying thereto the ratios referred to herein as indicating the average rise in wages and prices over the 1914 level for the years immediately following June 30, 1919, and adding to the result $100,500 to cover land and working capital, the rate-making values for the respective recapture periods are shown to be as follows:

Period Ended	Ratio	Rate-Making Value.
June 30, 1919	100	$850,500
Dec. 31, 1920	230	1,825,500
Dec. 31, 1921	195	1,563,000
Dec. 31, 1922	157	1,278,000
Dec. 31, 1923	174	1,405,500"

In respect of the weight given by the Commission to the enhanced prices reflected in these figures, the Commission itself, on page 39 of its Report said (R., 73):

> "It has been suggested that while it may be going too far to take current cost of reproduction as the basic measure of value, some weight ought to be given to changes in general price levels. Under the method outlined above we do give weight to such changes in so far as they have been reflected in prices paid for new construction or replacements, and we value lands at their prevailing market values. We know of no other way of giving weight to this factor which is not dependent upon caprice, unless full weight be given under the current reproduction cost doctrine. There is, in our judgment, no intermediate process possible which is capable of being applied by any rule independent of the caprice of those who apply it."

Thus the only consideration that the Commission gave to cost of reproduction at current prices, was to reject it altogether as a relevant fact entitled to any weight whatsoever. Enhanced prices was given weight only when reflected in actual cost.

The reason assigned for its rejection is consistent only with the view, contrary to the decisions of this court, that value *is a matter of mathematical formula* and that whatever formula was adopted, must be rigidly applied to the valuation of all railway property in the United States at all times and at all places. It did not therefore undertake to determine the value of the property of this particular carrier at the times in question by a consideration of all relevant facts and circumstances. Instead, it approached the case with the idea that the valuation of all railroad

property should be reduced to a matter of mathematical formula of easy and universal application to all railroad property in the United States and hence to the property of this carrier. It is said (R., 60) that "What we do in this case we must in principal do for all railroads in the United States." The difficulty and inconvenience of determining present value by a consideration of all relevant facts and circumstances, including cost of reproduction, is pointed out. On the other hand, it is stated that the method adopted has the advantage "that it is simple and easy of application and involves no great expense or delay, and that its results are capable of reasonably accurate forecast (R., 72). These are mere arguments of convenience and of administrative expediency. Neither convenience nor difficulty justifies a refusal to follow the law. *United States ex rel. Kansas City Southern Ry. Co. v. Interstate Commerce Commission*, 252 U. S. 178, 187-8; *People v. Wilcox*, 210 N. Y. 479, 486.

The purpose of the formula to be used should be, in the opinion of the Commission, as indicated in a preceding excerpt from its Report and elsewhere therein, to determine the amount of the approximate investment in all such property.

3. The true value of the carrier's property greatly exceeded that found by the Commission. The Commission must have so found if it had determined its value by a consideration of all relevant facts and circumstances, as required by the prior decisions of this Court.

The Commission thus refused to give any effective weight or any weight whatsoever to the reproduction cost

of this property solely by reason of the fact that its original cost was assumed to be less. In so doing it refused to give any consideration whatsoever to a relevant fact and based its determination of value primarily on the consideration of an irrelevant fact, *i. e.*, the assumed investment in the property.

This Court has never said that value is synonymous with cost of reproduction. The appellants do not so contend. Under the prior decisions of this Court, however, and under any rule the purpose of which is to determine *present* value, it is a relevant fact to be considered in connection with other relevant facts. It is the relevant fact which has most frequently been given controlling weight. On the other hand, where price levels have changed, original cost is not even a relevant fact material to the determination of present value, as was stated in *McCardle* v. *Indianapolis Water Company*, *supra*, p. 410-11. Where price levels have not changed, it becomes a relevant fact, not because representative of original cost but because original cost in such cases is the best evidence of what the probable cost of constructing the property would be in the period under review. In certain cases as, for example, in *McCardle* v. *Indianapolis Water Company*, *supra*, and in *Standard Oil Company* v. *Southern Pacific Company*, 268 U. S. 146, the circumstances were such that it was held that the value must be determined in such a way as to give dominant weight to reproduction cost. This is such a case. This is so because there are no relevant facts or circumstances which would warrant a finding of value for the structural property less than its current cost of reproduction, less depreciation, if any. In the absence of such facts or circumstances, re-

placement cost is "a fair measure of the value of the physical elements of the property" (*McCardle* v. *Indianapolis Water Company, supra*).

The distinction between the relevancy of reproduction cost and the irrelevancy of original cost does not rest entirely on judicial authority. Cost of reproducing a given article may not be synonymous with its value. It certainly, especially when price levels have changed, has a more direct bearing thereon than original cost and under the circumstances of the case may be, but not always, determinative of value. The value, for example, of a second hand automobile, is largely, if not primarily determined by the cost new at the time of a similar vehicle, with appropriate deduction for prior use and accrued depreciation. On the other hand, it is in no way affected by its original cost and may be more or less than such original cost, dependent upon advance or decline in the cost of a similar vehicle if new, and upon the extent of such advance or decline.

The same is true of railroad equipment. Of the carrier's property, more than half consists of locomotives and coal cars. This is movable, saleable property which, in the event of abandonment of the railroad itself, would have a market value. The Commission's value of all this equipment ($315,992) was based on pre-war prices prevailing at the time it was bought, less deduction for depreciation (Exhibit 20, R., 518-9). If its second hand value had been based upon the cost of similar equipment new in 1923 (using a factor of 174 per cent. as testified by the Commission's engineer), less the same percentage of deduction for depreciation, the value found would have been $549,840, which is $62,979 more than its

original cost when new ($486,861) (Ex. 20, R., 518-9). There was no evidence that any of this equipment was antiquated or obsolescent. Clearly, its market value as movable, saleable second hand property could not be ascertained by the formula employed by the Commission, but would approach, if not equal, its depreciated value on the basis of current prices if new. The principles which we have just discussed are those considered and sustained in *Standard Oil Company* v. *Southern Pacific*, 268 U. S. 146. The case deals with the value of a vessel, built in 1900 at a cost of $557,600, and lost in 1919 when its cost would have been approximately $1,750,000. A value of $750,000, although substantially in excess of the original cost, was held inadequate on the ground that it did not properly reflect the present cost of construction. Similar treatment of the carrier's equipment would, if no other charge were made, increase the total value found by over $225,000, or approximately one-fourth.

The same is true of a rail or a tie. The carrier purchased steel rails in 1923 at $48.02 a gross ton (R., 497), but such rail if placed in the track before June 30, 1914, was given a value new of $30.10 a gross ton, from which depreciation was deducted (R., 526). White oak cross ties and creosoted ties which, respectively cost this carrier $1.14 and $1.12 each in 1922 (R., 497), were accorded a depreciated value based on a cost new of 68c and 83c each (R., 525). Similarly, the major portion[1] of the car-

[1]The estimated reproduction cost at 1914 prices of property installed between July 1, 1914, and June 30, 1919, was $56,293.51. Deducting this from the reproduction cost less depreciation of all such property in use on June 30, 1919 ($678,806), leaves $622,212 as the value placed upon that part of such property included in the 1919 inventory in existence on June

rier's property in each of the recapture years was, as stated by the minority, valued without any regard either for its cost of reproduction in such years or for the increase in prices since 1914, which were taken to be representative of its approximate original cost.

The value of a public utility property, whether it be a railroad or a water plant, may be more or less than the sum of the cost of reproduction, less depreciation, if any, of its several units. Property is not all of the same quality. Consequently, the relevant facts and circumstances vary as to different properties, and no formula can be employed. The rule of *Smyth* v. *Ames* is a flexible rule adaptable to the circumstances of each particular case as it arises. Because money expenditures are not equally productive of value, a particular property may be worth less than its cost of reproduction at current prices. Such a conclusion, however, may not be based upon a consideration of its original cost. It must be based upon some relevant fact other than its cost of reproduction, by reason of which, as the result of the exercise of a fair and reasonable judicial determination, based upon facts of record, such a conclusion may be supported. In respect of the O'Fallon property there are no such facts. This particular property is clearly worth not less than its cost of reproduction, because of the facts pertaining to the nature and quality of the property.

30, 1914. This is approximately three-fourths of the total value placed upon all of the carrier's property in 1919, approximately two-thirds of the highest value placed upon its property in any of the recapture years ($978,874 in 1922 and more than two-thirds—nearly three-quarters—of the value placed thereon in 1920 and 1921) $856,065 and $875,360 respectively.

The O'Fallon is a well-located line affording transportation from certain coal fields to the markets of St. Louis. Its traffic is almost exclusively coal going in carloads in steady movements from these mines to St. Louis and the Northwest (R., 43, 295). Although there are twenty-nine railroads making deliveries to the St. Louis market besides the O'Fallon (R., 296), at times this little railroad has transported over twenty per cent. of all the coal moved into St. Louis (R., 298, 300). Its net railway operating income in each of the recapture periods and the resulting rates of return on its cost of reproduction new and less depreciation at prices current therein, plus the Commission's allowances for lands and working capital, and without any allowance whatever for appreciation, going concern or other elements of value, are shown in the following table.

Period	Cost of Reproduction New at Current Prices Plus the Commission's Allowance for Land and Working Capital	Cost of Reproduction Less Depreciation at Current Prices Plus the Commission's Allowance for Land and Working Capital	Net Railway Operating Income	Per Cent. Return on Value in Column 2	Per Cent. Return on Value in Column 3
(1)	(2)	(3)	(4)	(5)	(6)
10 months ended Dec. 31, 1920	$2,245,657	$1,605,794	$147,519.89	.0788	.1080
Year ended Dec. 31, 1921	1,851,103	1,348,725	182,726.73	.0987	.1355
Year ended Dec. 31, 1922	1,594,184	1,158,972	165,123.47	.1036	.1425
Year ended Dec. 31, 1923	1,730,622	1,216,901	169,103.98	.0977	.1390

Cost of reproduction and less depreciation in each of the years included in the table are those resulting from multiplying the cost of reproduction in each of such years at 1914 prices, as estimated by the Commission's en-

gineers and adopted by the Commission in its Report, by the index numbers testified to by the same engineer as properly applicable for the restatement of such cost of reproduction at prices then current.[1]

The rates at which these earnings accrued were those resulting from the advances authorized by the Commission in 1920 in *Increased Rates 1920*, 58 I. C. C. 220, as modified by *Reduced Rates 1922*, 68 I. C. C. 676. At such rates it will be observed that this carrier earned on its full reproduction cost in each of the recapture periods a return ranging from nearly 8% to over 10%, and on its cost of reproduction less depreciation from 10.8% to 14.25%. These figures indicate the high degree of public demand for the use of the facilities of this carrier. They likewise make it self-evident that if it had not been in existence during the recapture periods, the demand for such use, and the profits accruing therefrom under reasonable rates, would have justified its construction at the prices then current. If it had been then constructed, the Commission, under the method pursued by it, would have placed a value

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[1]Cost of reproduction during each of the recapture years, as estimated by the Commission's engineers and adopted by it, were (R., 56): 1920, $2,154,484; 1921, $1,853,578; 1922, $1,494,599; 1923, $1,636,832. As similarly estimated and adopted, the cost of reproduction less depreciation was: 1920, $1,514,621; 1921, $1,351,200; 1922, $1,059,387; 1923, $1,203,111. The same engineer who submitted these estimates testified "That in his opinion, as a result of his investigation, the ratios of the current unit prices at the end of each of the four recapture periods as compared with the 1914 unit prices, were represented by composite index numbers as follows, the 1914 prices being considered 100: For Dec. 31, 1920, 230; for Dec. 31, 1921, 195; for Dec. 31, 1922, 157; and for Dec. 31, 1923, 173" (R., 56). The figures in the foregoing table are therefore determined by multiplying cost of reproduction and less depreciation in each year by these index numbers and adding thereto the Commission's allowances for lands and working capital.

thereon at its cost of construction at the enhanced prices then prevailing. The fact that it was actually constructed in a period of lower prices does not make it worth less, except for such appropriate deduction for depreciation as should be made. As to this, no issue was raised before the Commission, and the question of depreciation is therefore not before this Court for review in this case. In a ten and a half year period beginning June 1, 1908, and ending December 31, 1918, the carrier's net railway operating income was $1,421,828 (R., 504-5) or an average per year of $135,000, which is approximately seven and seven-tenths per cent. of its full cost of reproduction new in 1923, as shown in the preceding table. Obviously, it would have been economical to build such a railroad with such an earning capacity at a cost greatly in excess of the pre-war cost used by the Commission as the basis of its determination of value and at a cost equal to those current in the year 1923. The value found by the Commission for the year 1923 through the use of its formula was $978,426 or $751,554 less. If depreciation is taken into account, the Commission's figure is still $238,475 short of the $1,216,901 shown in the table. On this for ten years, the Company's earnings had averaged better than ten per cent.

The Commission assigns no reason applicable to the property of this carrier, for denying full weight to the enhanced prices of the post-war period, other than the fact that the major portion of the property cost less. Such rejection cannot be justified on such a ground. On the contrary, it clearly appears that in the valuation of the property of this carrier by a consideration of all relevant facts and circumstances, effective and dominant

weight should have been given to such enhanced prices, resulting in values substantially in excess of those found.

In commenting upon the application of current prices in the determination of value, the Commission referred to the fluctuations evidenced by the factors showing the trend of commodity prices and particularly in the year 1920. Prices current in 1922, which was the *lowest* price level during the several recapture periods, and which the engineer of the Commission testified were properly represented by a factor of 157, if used in the determination of value, will produce a result so substantially higher than the value employed by the Commission, that the order must be condemned. In *McCardle* v. *Indianapolis Water Company, supra*, p. 411, this Court held that it was not necessary even in a rate case to establish the absolute permanency of a price level. It is sufficient if the level remain substantially on a plane for a period of three or four years. The monthly statistics of the Department of Labor show that the price level between 1923 and 1926, the Commission's opinion having been handed down in 1927, was a relatively stationary one, showing no greater fluctuations than those which have been common in the past (R., 258-9).

In the District Court, the carrier offered to prove that the level of railroad construction costs remained practically stationary from 1923 to the date of the hearing in 1927 (Offers 12 and 15, R., 277, 284-5). This testimony was, as appellants contend, erroneously rejected by the Court. Its purpose was to show the relative permanency of the price level testified to by the Commission's witness at the hearing before the Commission, which took

place on October 1, 1924, when such evidence as to permanency was not completely available. In any event, this Court will take judicial notice of the fact that prices have not receded to the pre-war level, but that after these violent fluctuations which occurred in the years immediately following the war, the cost levels have been practically stationary and on a plane substantially higher than those of the pre-war period.

It is not necessary for this Court to determine in this case precisely what level of prices shall be taken as representative of the post-war period. In refusing to give effective weight thereto, the Commission clearly erred. It is not necessary for the Court to determine the value of this property. The Court need not go farther in this case than to satisfy itself that the valuation attacked is substantially inadequate. *Minnesota Rate Cases*, 230 U. S. 352, 433; *San Diego Land etc. Co.* v. *Jasper*, 189 U. S. 439, 446.

4. The statement in the Report that there was a dearth of reliable data from which the cost of reproduction of the property of the O'Fallon could be determined at present prices is unsupported by any evidence, contrary to the evidence offered by the Commission itself and contrary to the fact.

The Report states (R., 75) that "* * * There is not in the present record evidence to show what it might have cost to reproduce the property of the O'Fallon at that time," and (R., 63) that "The record here shows that there was a dearth of reliable data from which an accurate estimate of such cost could be made for the period 1920 to 1923." This objection in justification of the disre-

gard for the law cannot be taken seriously. It is stated to be "only an incidental objection" (R., 63).

The statement that the record does not afford reliable data is contrary to the uncontradicted evidence offered by the Commission itself. As stated in the opinion of the minority Commissioners (R., 96), the present costs of construction were "established by competent testimony and undisputed." An experienced and qualified valuation engineer called by the Commission as its witness gave testimony as to the relative costs of construction in 1914 and during each of the recapture periods, based on authentic information derived from reliable sources, and enabling a correct and complete determination of the reproduction cost. As the Commission itself states (R., 56), this evidence based upon a "study of many sources of information, including reports of carriers in response to our valuation order No. 14, which reports show prices paid for major purchase of materials, and rates of compensation paid for labor, information obtained from bureaus of the Government, including reports of the Bureau of Labor Statistics of the Department of Labor, trade papers, and correspondence with manufacturers." The witness himself said (R., 341 *et seq.*):

> "I regarded the sources from which I obtained our index figures as authentic, as nearly as it is possible to get them. I said I got some of my information from the Department of Commerce, some from the Iron Age, etc. Regarding steel bridges, mainly I obtained the prices from the Iron Age. In other words, we give consideration to all those things. More particularly we rely on order 14, what the carriers pay for them. That is the large

carriers. Order 14 is where the carrier reports to the Commission their purchases for certain years. It is an order issued by the Commission.

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"Take account 8: We used order 14 strictly for carriers other than yours. Take the steel ties, for instance: We got our information from the U. S. Steel Corporation by correspondence, what steel ties were selling at in various years. Take treated cross ties: We relied pretty much on what the Frisco and the Pennsylvania paid for them during the recapture period, and did not use your annual report. Bridge and switch ties we relied on order 14 of the big roads. Account 9 we relied on order 14 from big roads. Account 10 the same thing, although we have various indices comprising various materials in account 10. When I say various indices I mean that a frog might have one index and a guard rail another, or a tie still another, or rail brace another, or switch stand; they are not always the same. In referring to order 14, I said something about the 5 major purchases. To explain that: A road sometimes buys some odd lots and pays a premium on them, because they are small quantities. We were simply concerned with the large purchases because we were reproducing the railroad as a whole, and we would naturally buy the entire quantity which is on the road at the date that we are talking about, and we have no occasion to buy little job lots. It was the five largest purchases under each of those accounts for each year.

"I do not think that there is any question that there is quite a variation in the prices of railroad commodities dependent upon the quantities that are purchased, unless you might have a standard con-

> tract where you could get a carload of this today and another carload tomorrow and something else next week. We have considered all those things in compiling these index figures. * * *"

The Report of the Commission states that in the years 1920-6 the investment in railroad property was increased by four billion dollars (R., p. 67). There was no dearth of experience.

VI.

THE INVESTMENT THEORY IS UNSOUND BOTH IN LAW AND ECONOMICS.

With commendable frankness the Commission has rested its findings of value upon the investment theory of public utility valuation. In order to sustain the order, the Court must overrule all of its prior decisions in which it has uniformly sustained the present value theory and rejected the investment theory. It therefore becomes important to consider the arguments advanced in support of the investment theory, both in the light of this Court's prior decisions, and on principle.

1. Irrespective of changes in price levels, this Court has repeatedly held that it is the present value of the property and not the dollars invested therein, that is protected by the Constitution.

The conflict between the investment theory of the Commission, and the present value theory, has been persistently before this Court for thirty years. In each case in which it has arisen the real question at issue has been whether it was the property of the utility and its value at the time of the inquiry, or the dollars originally invested in its property which were protected by the Constitution. In every case this Court has consistently held that it was the former and not the latter, which was the subject of such protection. It has so held when prices at the time of the inquiry were lower than during original construction, and also when they were higher.

(a) THIS COURT FIRST REJECTED THE PRUDENT INVESTMENT THEORY BECAUSE OF ITS OBVIOUS HARDSHIP TO THE PUBLIC, AT A TIME WHEN PRICES WERE SUBSTANTIALLY BELOW THOSE PREVAILING DURING THE ORIGINAL CONSTRUCTION AND THE RAILROADS INSISTED THAT THEIR INVESTMENT SHOULD BE PROTECTED.

It is said that the investment theory protects "every dollar invested and remaining in the property" (R., 72). This is an important argument advanced in its support in the report of the Commission. If it be true that the utility is only entitled to the protection of the "dollars invested" when prices have risen, it is entitled to the protection of the dollars invested when prices have fallen. But a review of the cases discloses that the very origin of the value doctrine was to secure relief from the hardships to the public from the protection of the investment, at a time when the property [expressed as *value*] was not really reflected by the dollars invested. The doctrine has been subsequently sustained against repeated attacks, because it has been obvious that only through recognition of the value of the property can the injustices be avoided which are inevitably consequent upon fluctuations due to a changing money standard. The "dollars invested" argument was first repudiated in *Smyth* v. *Ames*, at a time when prices were substantially lower than during original construction. During the Civil War and for a considerable period thereafter prices were exceedingly high. During this period the railroad property in question had been built. Thereafter the tendency of prices was downward, reaching its lowest level in the '90's. In *Smyth* v. *Ames* the question was, whether

the constitutional guaranty against the deprivation of property without due process of law, protected the railroad in a fair return on the dollars originally invested or on the then present lower value of the property acquired thereby. It was argued that it was unfair to deny to the Company a return on the dollars invested, just as it is now argued that it is fair to limit the earnings to a reasonable return upon the dollars invested, irrespective of changes in the price level and of depreciation in the value of the dollar. If the one is sound, so is the other. If either is unsound, both fall. This Court in that case rejected the dollars invested argument, and, held that it was the property of the utility and the present value thereof, not the investment therein, which was protected by the Constitution. It held that the value of such property should be determined as the value of property is customarily determined, viz., as a matter of judgment reflecting a proper consideration of all relevant facts and circumstances. The same question and substantially the same arguments were presented, and the same decision reached in *San Diego Land and Township Company* v. *National City*, 174 U. S. 757; *Cotting* v. *Goddard*, 183 U. S. 91; *San Diego Land and Town Co.* v. *Jasper*, 189 U. S. 442; *Stanislaus Co.* v. *San Joaquin & King's River C. & O. Co.*, 192 U. S. 214. These cases are significant because they show that following the decision in *Smyth* v. *Ames* the utilities vainly attempted to establish the very proposition which the Commision now seeks to establish.

(b) IN THE MINNESOTA RATE CASES, 230 U. S. 252, WHEN THE LEVEL OF PRICES HAD BECOME SUBSTANTIALLY HIGHER THAN THOSE DURING ORIGINAL CONSTRUCTION, THIS COURT ADHERED TO ITS PRIOR DECISIONS AND IN SO DOING CONSIDERED AND REJECTED SUBSTANTIALLY EVERY ARGUMENT NOW ADVANCED IN SUPPORT OF THE "DOLLARS INVESTED" THEORY.

In this case the parties changed sides. The relation of prices at the time of inquiry and on original construction, respectively, have become reversed. It was thus to the advantage of the public to establish original cost as the basis of regulation in order to keep rates down. The public authorities who had hitherto opposed the investment theory therefore became its champions. Similarly, the representatives of the utilities became the proponents of the present value theory. The abstract of the briefs in this case, as contained in Volume 57 of the Lawyers' Edition of the Supreme Court Reports, shows that every important argument now advanced in support of the investment theory was presented to the Court. The State contended: (a) that there are many property rights and elements of value held by a public service company which it has received as a free grant from the public, which in a sale or condemnation of the property must be given consideration; but inasmuch as these were free grants, when the question is one between the corporation and the public as to reasonable rates, the items must be excluded (57 L. ed. 1517); (b) That, inasmuch as railroads are performing functions of the State, the rights of the railroads are to be determined by the same rules as would be applied to the State had it performed the functions

itself, and (c) That in no case should the return be computed on a sum greater than the original investment, citing *Re Advance in Rates*, 58 I. C. C. 347, where the Interstate Commerce Commission stated, as in its Report in this case, that "the nearest approximation to a fair standard is that of *bona fide* investment—the sacrifice made by the owners of the property—considering as a part of the investment any shortage of return that there may be in the early years of the enterprise" (57 L. ed. 1519).

It will thus be observed that substantially the same arguments now advanced were pressed upon the Court in that case, including the argument that railroad or public utility property is not private property and is not entitled to the full protection accorded by the Constitution.

The answer of this Court was decisive as to these contentions. The Court said:

> "It is clear that in ascertaining the present value we are *not* limited to the consideration of the amount of the *actual investment*. If that has been reckless or improvident, losses may be sustained which the community does not underwrite. As the company may not be protected in its actual investment, if the value of its property be plainly less, so the making of a just return for the use of the property involves the recognition of its fair value if it be more than its cost. The property is held in *private ownership* and it is *that property* and not the original cost of it of which the owner may not be deprived without due process of law" (p. 454). (Italics ours.)

(c) NOTWITHSTANDING THE GREAT ENHANCEMENT IN PRICES WHICH HAS TAKEN PLACE SINCE THE WORLD WAR, THIS COURT HAS ADHERED TO ITS PRIOR DECISIONS.

Immediately after the termination of the war various utilities found themselves in dire straits because their rates, artificially restrained by legislative or commission action, were not rising with the cost of labor and materials. The State Commissions made a determined effort to prevent the utilities from having the value of their properties measured in terms of the current depreciated dollar. They refused to give effect to present day reproduction costs in making valuations for rate-making purposes. Consequently, the issue immediately went to the courts in a large number of cases. These cases culminated in decisions of this Court in which the doctrine of *Smyth* v. *Ames* was again examined and again sustained. These cases sustained the law as declared in *Smyth* v. *Ames*, and reaffirmed in *Minnesota Rate Cases*, and held that the true present value of public utility property is the test of the constitutional rights of its owner rather than the dollars originally invested therein. *Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U. S. 276; *McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400; *Bluefield Co.* v. *Public Service Commission*, 262 U. S. 679; *Pacific Gas etc. Co.* v. *San Francisco*, 265 U. S. 403; compare *Standard Oil Company* v. *Southern Pacific Co.*, 268 U. S. 146.

In the separate opinion of Mr. Justice Brandeis in *Southwestern Bell Telephone Co.* v. *Public Service Commission*, concurring in the result but dissenting from the reasoning of the Court, substantially every argument now advanced to break down the rule of *Smyth* v. *Ames* and

in support of the investment theory, was pressed upon this Court and rejected by it.

2. The present value theory is supported by principle as well as by precedent.

The statement in the *Minnesota Rate Cases* that "the property is held in private ownership, and that it is that property and not the original cost of it of which the owner may not be deprived without due process of law," rests on a solid foundation. The counter-statement of Mr. Justice Brandeis in his dissent from the reasoning of the majority in *Southwestern Bell Telephone Company* v. *Public Service Commission*, *supra* 290, that "The thing devoted by the investor to the public use is not specific property, • • • but capital embarked in the enterprise" is, it is respectfully submitted, based on a false premise.

Implicit in this statement is a recognition of the fact that whatever it is that is devoted to public use is the thing that is subject to public regulation and to constitutional protection in such regulation. But the dollars originally invested are not, and never were, devoted to public use or subject to regulation. By their expenditure tangible physical property was acquired. It may not be doubted that it is that property now used, not the dollars invested therein at some remote time, which is devoted to public use and the subject of public regulation and protection by constitutional restraints in the exercise of such regulation. The property owner whose rights are at issue, is the present owner of the property now devoted to public use. His present sacrifice and return, cannot be those of that remote original investor and owner.

The Fifth and Fourteenth amendments do not protect the money invested in property but the property itself. In a condemnation case no one would think of contending that the owner was entitled to a return of the money invested in property taken for public use, if greater than the present value of such property, or that constitutional guaranties would be satisfied with such return, if it were less. There can be no distinction between that which is protected by the constitution in a condemnation case and in a rate or other case involving the regulation of the use of property. In each case it is the property which is the subject matter and which is protected by the constitution.

All discussion of the effect of the value and investment rules upon the rights and returns of stockholders and bondholders is wholly beside the point. Such arguments confuse the property of the corporation itself, subject to public regulation, with the property of its various classes of security holders, who are not subject to public regulation. Introduction of the question of the rate of return to the private investor in the securities, instead of to the corporation itself, is the introduction of a new and extraneous element having no legal significance.

3. The investment theory is economically unsound and rests upon the illusion that the dollar is a fixed and unchanging standard of value.

The prudent investment theory rests on the illusion that the dollar of to-day is the same as the dollar invested before the late War. But the dollar is a mere medium of exchange. It permits the expression of the current relationship between different kinds of property in terms

of a common denominator. That denominator is supposed by some to be a fixed standard. Actually it is not. The economic nature of the transaction, when the investment was originally made in the O'Fallon, was that other property (that is, "capital goods", to use the economists' language, consisting of lead, coal, grain, etc.) was exchanged for the railroad by means of money as a medium of exchange. Since then this medium has changed in purchasing power. The actual sacrifice involved by the original investment (that is, the quantity of capital goods) is not now truly expressed by the number of dollars originally invested. Consequently, it becomes clear that the Commission's theory, contrary to its claim (R., 72), does not protect the actual investment. It recognizes the number of dollars invested but not the actual sacrifice. The theory does not recognize that the dollars originally invested are as radically different from the dollar of today as American dollars and Mexican dollars. In *Consolidated Gas Co.* v. *New York*, 157 Fed. 849, 854, Judge Hough aptly and correctly stated this fundamental proposition:

> "If fifty years ago, by the payment of certain money, one acquired a factory and the land appurtenant thereto, and continues today his original business therein, his investment is the factory site and the land, not the money originally paid. • • • The so-called 'money value' of real or personal property, is but a conveniently short method of expressing present potential usefulness, and 'investment' becomes meaningless if construed to mean what the thing invested in cost generations ago."

Where the dollar is subject to wide fluctuations, as it is, the only possible means of really protecting the in-

vestment is to state it in terms of present-day dollars. The failure to do so is the vice in the original dollars invested method. On proper analysis it appears that the only difference between the original cost as of 1910, and the reproduction cost as of 1920-3 for the O'Fallon railroad, considering the same items of property and elements of cost, is that the former is expressed in past prices measured in an obsolete dollar, whereas the latter is measured in the dollar of today. There is a wide dollar difference but no actual difference between an appraisal of the same property made in 1914, in 1914 dollars and one made in 1926, in 1926 dollars. Similarly, what the Government now proposes to do in this case is to deprive the carrier of certain income which has only the *appearance* of being high. Prices having greatly increased as a result of the war, the O'Fallon should now earn a proportionately higher return in order for its income to procure the same quantity of capital goods. But the Commission now insists that the income be measured in terms of pre-war dollars, without equating them in recognition of their decreased purchasing power. This results in a deprivation of real income through accepting the illusion that the dollar is a fixed standard.

The Government is attempting to recapture earnings made from hauling coal, mined under the increased post-war wages and sold at the higher market prices. The wages, the market price of coal, and the cost of construction of the railroad during the period in question were all high because of the depreciated dollar. But the Government is unwilling to accord the same treatment to the railroad that is accorded to industry and labor generally, when

all costs and prices have been substantially increased. Therefore, it is not true that to measure the value of the railroad property in terms of the existing dollar is to "single out one class of investors for special (favorable) treatment" as suggested in the concurring opinion of Commissioner Eastman (R., 88). The prices of practically all commodities and the wages of labor have shown a general increase since the war, and with unimportant exceptions, the industrial world has accommodated itself to this new order of things. This is evidenced by the great prosperity of American industry at the present time, when industry as a whole is securing even more than its normal returns and is doing business in the terms of values and costs measured with the present dollar. The public utilities of the country, other than railroads, as a result of the decisions of this court have not been excluded from the operation of this economic law which has affected all of the monetary transactions of the country. The railroads should not be excluded, and cannot be, without actual deprivation of property.

With falling prices, on the other hand, the dollars invested theory would result in singling out a single class of property and its owners for beneficial treatment. With a fall, for example, of fifty per cent. in prices, a public utility, if permitted to receive a fair return on the original dollars invested, would receive just twice as many dollars as under the present-value theory. The purchasing power of these dollars would be twice as great as the purchasing power of the dollar invested. It was to relieve the public from the hardship resulting from such special treatment that the present value rule was originally established in *Smyth* v. *Ames*. It is a rule that is sound both in law

and in economics and is the only rule by which injustices inherent because of the fluctuations in purchasing power of money, may be avoided. By it, the pecuniary rights of all parties are maintained on the same standard. The manifest injustice, in a time of falling prices, of compelling the public to pay rates based on the original dollars invested at a time when the purchasing power of that money was greatly higher, is self-evident. On the other hand the injustice of denying to a utility a return on the value of its property, measured in terms of a depreciated dollar of a greatly diminished purchasing power, is equally obvious, and for the same reasons. Whether it may exact such rates as to pay it a return upon such a value without interfering with the free flow of commerce is an entirely different question, which we shall consider subsequently. But this is a practical question, which is always present, whatever the price level. As a matter of law and economic theory it is entitled to receive such rates, if it can get them.

As a part of the argument in support of the investment theory, the Commission points to the desirability of stabilizing values. This argument is without foundation either in law or in economics. The attainment of a stability of value or of income, as we have shown, really requires the stabilization of the dollar. There is merely an illusion of stability, if value and income are regarded as remaining the same, merely because the same when expressed in dollars, which are not equivalent in purchasing power. The dollar value of property, whether it be real or other property, is not static, nor, is there any power in the legislative branch of the Government to make it so. The actual effect of the Commission's process of

stabilization is a deprivation of property and not a stabilization of values.

That the value of property is not static, the Commission itself recognizes in part. In appraising railroad lands at their present value it recognizes that a railroad company, like all other land owners, is entitled to the increment of value arising from an enhancement in its price and likewise must suffer a decrease or deflation. There is no basis for distinction between the carrier's real estate and its other property. On the Commission's theory, if a carrier erects a passenger station on a tract of land, the value of that land, like the value of the adjoining land, fluctuates with the current market values, but the value of the building is asserted to be unaffected by changes in the cost of labor and materials, although the value of the buildings erected on adjoining land and devoted to private uses is so affected.

The foregoing review which deals with effects of changes in the value of the dollar demonstrates that the dollar invested theory is an *arbitrary* method because it measures the rights of the property owner in the fixed terms of the dollar invested, without recognizing that the actual rights of the property owner are not truly reflected by the particular kind of dollar originally invested. There are other and broader consequences of the arbitrariness of the theory. Railroads ordinarily operate in competitive fields under common standards of rates, fixed for all the carriers and not for a particular carrier. If there were two roads between the same termini, alike or identical in construction, and differing only in that one was built in 1897 at low costs, and the other in 1925 at high costs, under the Commission's theory one will have a much

greater value than the other. The Commission's arbitrary rule will subject only one to recapture, although the roads are substantially identical, perform the same service, and should be entitled to the same return.

4. The economic considerations put forth in support of the use of the investment theory are unsupported in fact, unsound in law, and constitute a "scare" argument which contains no "scare".

The Report (R., 61) says: "It may well be that the valuation of railroads on a national scale requires the beginning of a new chapter in valuation". It is not plain whether by this statement the Commission meant to suggest that the present value rule which has been applied by this Court to the valuation of all public utility property, including railroad property, should be completely discarded for the investment theory, or whether a distinction should be made between the principles governing the valuation of railroads and those governing the valuation of what the report describes as "local utilities" (R., 27). Either suggestion is unsound either in law or economics. The right of a railroad company to the protection of its property under the Constitution is no less than that of a so-called local utility, as the dissenting commissioners state (R., 95).

On the economic side, certain observations in the Commission's Report (R., 65-69) are apparently intended to suggest that unfavorable economic consequences *might* result *if* full weight were given to cost of reproduction at current prices in determining the value of every railroad in the United States, and *if* rates were established to yield

a fair return thereon. The same argument might have been made in any of the cases in which the present value rule has been applied since the War. It has no legal significance.

It is equally without practical foundation. The suggested possibilities are wholly speculative, greatly exaggerated, and rest on no proof whatsoever. They are aptly described at the conclusion of the separate dissenting opinion of Commissioner Woodlock (R., 100) as "the majority's lurid picture of the distressing consequences which it thinks are inherent in the application of the valuation principles declared by the Supreme Court as the law of the land."

(a) As appears on the face of the Report no unfavorable economic consequences are to be anticipated by adherence to the "present value" theory.

The Commission's observations in respect of this matter may be properly characterized as a "scare" argument designed to lead this Court to hold that, although it has applied the present value rule to other public utilities, it should not be applied in the valuation of railroad property. It is a "scare" argument which contains no "scare." In its Report the Commission itself is careful to make no such prediction. The possibilities of any such consequence arising are, as indicated in the Report, remote.

At various places in the Report, the Commission speaks of the economic consequences which *would* have resulted in the recapture years if full weight had been given to cost of reproduction at spot prices in determining the

value of every railroad in the United States, and if rates had been established, designed to yield a fair return thereon. Rates were not so established, and the economic consequences suggested did not occur. It appears on the face of the Report that the majority itself anticipates no unfavorable economic consequences for the future through adherence to the present value rule, but rightly believes them to be so highly improbable as to be practically impossible of realization.

On page 33 of the Report, after stating that the railroads have not in the aggregate earned the statutory rate of return, the Commission says (R., 67):

> "Yet they have accepted our findings and have, except in western territory to the extent above indicated, shown little disposition to seek further general increases. They have realized that to do so would be to risk conflict with inexorable economic conditions."

In respect of the western situation the Commission said (R., 68):

> "Even now, when the general price level is materially lower than it was in 1920, a rate base so determined would in all probability require rates which the carriers would as a matter of self-interest hesitate to charge. The position which the carriers took in *Revenues in Western District*, 1925, 113 I. C. C. 3, is evidence to that effect."

The case referred to is a recent one in which the advances sought were substantially less than those required to bring the income of the Western carriers up to a fair return on the value of their property.

Referring again to the general situation, the Commission at the conclusion of the discussion observes that it is all

> "on the assumption that the traffic would bear the increase in freight rates necessary to produce such returns, an assumption which, as we have seen, is probably contrary to the fact" (R., 35).

The Commission might have gone considerably further in expressing doubt as to the materialization of the economic consequences suggested. It might have referred to the fact that the duty imposed by the rate-making rule is a duty to be performed by the Commission "in the exercise of the power to prescribe *just* and *reasonable* rates." It might have referred to the proviso in the rate-making section (paragraph 2) which modifies that section by providing "that the Commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust or unreasonable and to prescribe different rates for different sections of the country." It might have pointed out that under the authority conferred by this proviso and despite the fact, as stated by the Commission, that the carriers had not earned the contemplated rate of return, it had, nevertheless, since the passage of the Transportation Act, reduced thousands of rates, as evidenced by its published reports. As an example it might have instanced its decision in *Rates on Grain and Grain Products and Hay*, 64 I. C. C. 85, in which, at a time when the returns of the carriers were far below the statutory rate of return, it reduced all rates on such products ten per cent. largely by reason of the economic situation found to exist in respect of this industry, and the necessity for stimulation of traffic (pp. 88-92, 99-100). It

might have pointed out, as stated in that case, that the carriers had made many similar reductions from the same considerations and for the same purpose. It might have pointed out that, in *Reduced Rates, 1922,* it made an horizontal reduction of 10% in all the rates previously established as a result of the increases authorized in *Increased Rates, 1920,* although it appeared on the face of its Report that in none of the rate groups fixed by the Commission were the carriers earning the statutory rate of return. It might have pointed out that in the Western case referred to, the carriers were not only restrained by self-interest from seeking the full measure of advance to which they were theoretically entitled, but that the Commission denied even the modest advance in rates sought, notwithstanding the fact that the revenues of the western carriers were plainly inadequate. Between the self-interest of the carriers in the preservation of their traffic and the Commission's control of the situation under the proviso of paragraph 2, it may, we believe, be fairly assumed that no untoward consequences would result in the way of exorbitant transportation charges by adherence to the present value theory. As indicated from the foregoing quotations from its Report, the Commission is evidently of the same view.

Finally, if such results should occur, they are directly attributable to the policy of Congress in providing that rates shall be such as to insure a fair rate of return upon the aggregate value of railway property.

No carrier, of course, has any constitutional right to the continued maintenance of such a rule. It is of right only entitled to demand that the rates shall be such as to yield a fair return upon the value of its own property.

Since railroad traffic is largely competitive, its ability to take practical advantage of this right is dependent upon whether its competitors also can make a case of confiscation. No competitor of the O'Fallon, for example, could obtain relief from existing rates, under any theory of valuation because the O'Fallon could not. The same situation exists in any part of the country where established rates yield a fair rate of return upon the value of any important carrier therein. This is true whatever the rate making rule.

No provision of the Constitution requires Congress thus to base rates on average conditions, or requires it to continue such policy. The present rate-making rule is believed to be a salutary rule. It has led to no unfavorable economic consequences in the past. Despite its observations as to what might have been or might be the Commission is obviously of the view that it will lead to no unfavorable economic conditions in the future. If, contrary to such expectation, the restraint of self-interest and of the power reserved to the Commission in the maintenance of individual reasonable rates should turn out to be inadequate to protect the commerce of the country against exorbitant charges under the rate-making rule prescribed by Section 15a as it now reads, Congress has full power either to repeal or modify it.

The suggestion of possible but highly improbable unfavorable economic consequences through adherence to the present value rule under the existing rate making provisions of the Act, is no justification either for a departure therefrom or for a failure to determine the value of this property by a consideration of all relevant facts and circumstances.

(b) THE SUGGESTIONS MADE ARE WHOLLY SPECULATIVE AND BASED ON NO PROOF, AND THE POSSIBLE, ALTHOUGH, ADMITTEDLY HIGHLY IMPROBABLE, CONSEQUENCES ARE GREATLY EXAGGERATED.

The Report speaks of advances of from 75 to 90 per cent., which might have been necessary *if* rates had been advanced in 1920 so as to yield a fair return on values predicated on cost of reproduction. These percentages are based on the application of spot prices of that abnormal year in the valuation *of all* the railroads. The law does not require the use of spot prices (*McCardle* v. *Indianapolis Water Company, supra*). The extent to which advances would now be required is not stated. The inference which the Commission obviously seeks shall be drawn is that they would be very great.

The extent to which property values would be increased if full weight were given to cost of reproduction at prices now current in determining the value of every railroad is not stated. Since it is unknown, it could not be stated. Nor does the law require the rigid application of such a basis of value. The value of each property is to be determined by a consideration of all relevant facts and circumstances. All railroad property is not alike.

From the record in this case, however, the advances which would be required, if rigid application were given to such formula in substitution for the one employed by the Commission, may be approximated within reasonable limits. As pointed out by Commissioner Taylor, operating expenses and taxes consuming about eighty-two per cent. of total disbursements (Report, 67). In the year 1926 the aggregate net railway operating income of all

railroads was $1,229,000,465 (*41st Annual Report, Interstate Commerce Commission 1927,* Table V, p. 109) out of aggregate income of $6,382,939,546 (*41st Annual Report, supra,* Table VI, p. 109), or a little less than twenty per cent. Any increase in aggregate value, therefore, affects but twenty per cent. of the rates.

On page 31 of the report it appears that, if current cost of reproduction at 1923 prices be substituted for reproduction cost at 1914 prices, the value of the property in 1923, exclusive of lands and working capital, would have been $1,405,000. This figure, as appears on that page, was determined by applying the Commission's engineer's index factor of 174 to the value of $750,000 placed upon the carrier's property, other than lands and working capital in 1919, and adding thereto the allowances for lands and working capital ($100,500). Adding, as the Commission does the sum of $127,746 (the additions to the property since June 30, 1919), produces $1,533,246. This is 156.7 per cent. of the Commission's valuation for 1923 ($978,246). If it be assumed that the substitution of such a valuation for a value based on original cost or 1914 prices would produce substantially like results if applied to all railroads, there would be a resulting increase of 57% in aggregate value. An increase of 57% in that part of the revenues applicable to a return on the investment, (to wit 20%) would call for an advance in the rate level of 57% of twenty per cent., or 11.4% to provide a return on such increased value. If, instead of applying the 1923 index number of 174, the index number shown on the same page of the Report for the year 1922 (157) be applied, and the same allowances for working capital, materials and supplies, and the same additions for subsequent

improvements be added, the value in 1923 becomes $1,405,746, or 144% of the value found by the Commission. The railroad index factor of 157 used by the Commission's engineer in 1922 accords substantially with the Bureau of Labor's all commodity index of the last few years, representing the purchasing power of the dollar as compared with its purchasing power in pre-war times. A 44% increase in that portion of the rates applicable to a return on the investment would require an increase of 44% of 20% or 8.8%. Both of these assumed factors of rate increase are too high because all additions and betterments, subsequent to 1919, are taken in at their full cost, many of which were made at prices higher than those which now prevail and under the cost of reproduction method would be reduced.

In *Increased Rates 1920, supra,* the Commission authorized advances in freight charges of 40% in the Eastern Group, 25% in the Southern Group, 35% in the Western Group and 25% in the Mountain-Pacific Group. If it occurred to anyone within or without the Commission at that time, that such advances would lead to untoward economic consequences, no such suggestion is noted or commented upon in the report of the Commission. The increases allowed in 1920 did not become effective until August 26. They are not, therefore, fully reflected in the statistics of that year. They are completely reflected in the 1921 earnings in which the average receipts per ton per mile were 1.275 cents. As a result of the general reduction made in 1922 and of the successive reductions which the Commission has since made, the average receipts per ton per mile in 1926 were 1.081 (*41st Annual Report of Interstate Commerce Commission,*

December 1, 1927, Table XII, p. 114). An increase of 11.5 per cent. applied to the traffic of 1926 would increase the earnings per ton per mile of that year 1.205, or still below those of 1921 accruing under the advances made in 1920. An increase of 8.8% applied to the traffic of 1926 would increase the earnings per ton per mile of that year to 1.176, or very materialy below the per ton mile earnings accruing under the advances made in 1920. As stated, there was no suggestion when the rates were advanced in 1920 that they would result in the exaction of unbearable charges. American industry has since reached heights never before attained in the way of either profits or volume of business done. Neither does it appear what the effect of such advances would be upon commerce. If, with such re adjustment of individual rates as the Commission is authorized to make under the proviso to paragraph (2) of Section 15a, it continued to move freely, there would appear to be no reason why the price of railroad transportation, like the price of other commodities and services, should not be measured in terms of the present dollar. If by reason of such advances traffic did not move freely, the advances either would not be made, or if not made, would not be maintained. The whole argument is a "scare" argument based wholly on speculation and supported by no proof. The advances indicated are certainly not such as to shock the conscience.

Reference has already been made to the attempt of the Commission to suggest a distinction in point of constitutional principle between the railroads and the other public utilities. Clearly, there is no distinction. If this Court is to hold that the rights of the owners of a railroad are

to be adjudicated on an original cost basis, the conclusion is inescapable that the rights of an owner of an electric interurban line, an electric light and power plant, or of a telephone company, (the scope of whose activities are frequently, and in some cases generally, of an interstate scope), must be adjudicated on exactly the same basis. The state commissions, in their regulation of "local" utilities, have endeavored to escape the effect of constitutional restraints arising from the doctrine of *Smyth* v. *Ames*, a case involving the Union Pacific Railroad, and have urged the very same reasons to justify their action, which are urged by this Commission. In the footnote[1] is shown the investment in the so called "local" utilities, including the electric light and power, electric railway, telephone, gas and water companies. The aggregate present investment is approximately 22 billion dollars. As a result of the decisions of this Court, the charges of these utilities, speaking generally, have been increased so as to yield a fair return on the value of their property.

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[1]The following shows the book investment as of Jan. 1, 1928, in the property and equipment accounts of all the important utilities, not publicly owned, other than railroads, and excepting the telegraph companies:

Electric Light and Power[2]	$8,084,000,000
Electric Railway[3]	5,400,000,000
Telephone [Amer. Tel. & Tel. Co. and Independents][3]	3,500,000,000
Water[3]	571,911,000
Manufactured Gas[4]	2,700,000,000
Natural Gas[4]	1,650,000,000
	$21,905,911,000

[2]"Electrical World" issue of January 7, 1928, pages 32, 33.
[3]Statistical Abstract of the United States, Year 1928, published by Department of Commerce, page 200.
[4]American Statistical Bulletin No. 6, October, 1928, table 3.
[4]American Gas Association Monthly, November, 1928, page 655.

The aggregate of such advances must be far greater than those which would result from basing rates on the present value of railroad property. No unfavorable consequences have resulted from such advances in the rates of other public utilities, nor has this Court hesitated to adhere to the present value rule in determining the value of such utilities because of speculation as to consequences that might result. It should not do so in this case.

VII.

THE ORDER OF THE COMMISSION IS VOID BECAUSE ITS FINDINGS OF VALUE ARE PURELY ARBITRARY AND, ON ITS OWN THEORY OF VALUE, UNSUPPORTED BY ANY EVIDENCE.

1. Even under the Commission's theory of value its order is void because its findings are unsupported by any evidence.

The order of the Commission is void even upon the theory expounded and adopted by the Commission, because unsupported by any evidence whatsoever. The Commission found that the original cost of the property could not be ascertained (R., 54). This finding was based upon a report of its Accounting Section to that effect, offered in evidence by the Commission itself in the proceedings before it (R., 508). No evidence to the contrary was offered by any party. As appears on the face of the Report (*supra*, p. 52 *et seq.*) the application of so-called 1914 prices to the inventoried quantities of June 30, 1919, and the addition thereto of the amount by which actual cost of units installed between July 1, 1914, and June 30, 1919, were resorted to, in the absence of original cost, as an approximate determination thereof. It may be admitted that by such a process the investment in the units installed subsequent to July 1, 1914, may be determined. Implicit in the formula, however, is the assumption that by the application of so-called 1914 prices to the remaining units, the investment therein may be determined.

This assumption rests on no proof whatsoever. In making it the Commission relied solely on the statement quoted in its Report (R., 76) from its prior report in the *Texas Midland* case, that "the cost of producing and equipping a railroad in most parts of this country on June 30, 1914, was a fair average for at least the twenty years preceding." This was a mere dictum, part of a general discussion, and pertinent to no specific issue involved in the case. The evidence, if any, in that case, upon which the quoted statement was based, was not introduced in these proceedings. No one so testified in this case. No evidence whatsoever was offered either by the Commission, or by the carrier, showing or tending to show that the approximate investment in the carrier's property could be determined by the formula employed. The report of its engineering section, offered by the Commission itself, and containing its estimate of the cost of reproduction of the carrier's property as of June 30, 1919, at 1914 prices, was not accompanied by any statement that its purpose was to determine the approximate investment in the carrier's property (R., 3336, Exhibits; R., 514-575). Neither were the estimates subsequently introduced by the Commission of its cost of reproduction in the recapture years at 1914 prices. On the contrary, the Commission's engineer, by whom these estimates were introduced, gave evidence as to the index factors which should be applied thereto in the restatement of such cost of reproduction at prices current in the recapture years (R., 336, *et seq.*). From beginning to end, there is nowhere in the record any suggestion on the part of any representative of the Commission that these estimates were offered as estimates of original cost.

2. The method pursued, as described by the Commission itself, is one by which it is impossible to determine the approximate investment in the property of this or any other carrier.

Under the Commission's formula, cost of reproduction at 1914 prices, of the carrier's property, other than lands and working capital, was taken as an approximation of the actual investment therein, in the absence of evidence of original cost. In making such estimate the Commission pursued the methods described in its "valuation reports under Section 19a" (R., 71). These methods are fully described in the *Texas Midland* case, to which express reference is made in the report (R., 55). The actual elements of original cost and the elements included in the Commission's reproduction estimates at 1914 prices, as described in that case, differ widely. The nature and extent of these differences are such that it is impossible to determine the approximate investment in this or any other property, by the use of the methods therein described.

As disclosed by the decision in *Texas Midland, supra,* the Commission omits many original cost elements from the reproduction appraisal, now said to be usable as a substitute for original cost. The Commission there said (p. 115): "The estimate of reproduction cost arrived at in this manner does not correspond with the original cost of producing the property as it was in fact produced." Nothing is included for reconnaissance and preliminary surveying, since in reproducing the line the exact location would be known (*Texas Midland Railroad, supra,* pp. 27 8). Moneys expended for bond discount, a legitimate

original cost expenditure, are not allowed (*Texas Midland Railroad, supra*, p. 154). Assessments for public improvements are excluded (*Texas Midland Railroad, supra*, p. 19). The Commission's reproduction theory assumes the existence of all the *present* conditions which affect construction difficulty and expense, and not the conditions originally existing. The construction costs ascertained may therefore be much lower (*Texas Midland Railroad, supra*, pp. 15, 115, 139, 140). The carrier may originally have cleared its right of way through a forest. But nothing is included in the reproduction estimate for clearing, if the adjoining lands are now cleared (*Texas Midland Railroad, supra*, pp. 114-5, 117). No allowance is made for contingent costs of construction, as such, which frequently run into large amounts of money (*Texas Midland Railroad, supra*, pp. 25, 142). Interest during construction, and all overhead expenses, pertaining to land, are entirely excluded, although a necessary part of original cost (*Texas Midland Railroad, supra*, p. 33). Although the Commission states that the cost of acquisition of land for right of way is from 150 to 300 per cent. of the acreage value which it determines (based upon the acreage value of adjoining non-carrier lands), and although such costs would be a part of the original cost of the property, they are excluded from the Commission's land value (*Texas Midland Railroad, supra*, pp. 52-5, 170-2). As we have explained, the Commission deducts a theoretical straight line depreciation, and adds an arbitrary five per cent. allowance, the nature of which the Commission declined to disclose. Neither element has any relation to original cost. Furthermore, the Commission

excludes all money actually invested in cash working capital (R., 59).

Thus, the Commission's claim that approximate original investment may be determined by estimating cost of reproduction at 1914 prices in the method used by the Commission, is contrary to the fact. Such statements as these are incorrect: "It (that is, the Commission's method) insures fair treatment to the investor because a fair return will be secured for every dollar that has gone into the project * * *" (R., 72); "Bear in mind that the fair value (that is, as determined by the Commission) represents a maximum investment of every dollar that has gone into the property * * *" (p. 91).

The methods pursued in the determination of value under Section 19a were established prior to the War and before the increase in prices which has since occurred. They were clearly intended to establish cost of reproduction at the prices then prevailing for the purpose of basing value primarily thereon. Such being their purpose, many items of original cost, as disclosed above, were entirely excluded, and the actual cost of all units of property installed prior to the pricing period intentionally disregarded. This was proper since the purpose was to arrive at the then present cost of reproduction. Except for the subsequent enhancement in prices, it is a fair inference that the Commission would have continued its original policy of disregarding original cost and of determining present value on the basis of cost of reproduction. As stated in the Report of the dissenting Commissioners (R., 96-7), in failing to apply corrective factors to the reproduction estimates at 1914 prices, the Commission has departed from its original purpose, as

expressed in *Winston-Salem Southbound Ry. Co., supra*, 192, in which it was said that corrective factors would be applied to the values of property other than land, which had been determined as of June 30, 1914 "as the normal trend of prices of labor and material may go upward or downward." This intention was expressed in the *Texas Midland* case, *supra*, and incorporated by reference in subsequent valuation reports (R., 97). As stated by the minority, "the departure by the majority from our hitherto declared purpose is unmistakable" (R., 97).

In order to get away from substituting current prices for those of the pre-War period by the use of such corrective factors, it is now asserted that these estimates may be supported as estimates of original cost. Their very composition and purpose precludes their adoption as such. The Commission, therefore, in addition to determining value by an arbitrary mathematical formula, has adopted, (under its new theory that investment should be substituted for actual value), an arbitrary formula for the determination of original cost, by which it cannot possibly be ascertained, and the ascertainment of which was contrary to the original purpose of its adoption.

It is frequently stated that the rule of *Smyth* v. *Ames* "involves forming an opinion or exercising a judgment, as distinguished merely from ascertaining facts". (*Southwestern Bell Telephone Company* v. *Public Service Commission*, *supra*, opinion of Justice Brandeis, page 294). The Commission's investment method, in approximating an assumed investment by means of a reproduction estimate, has double complications, and in no respect has that simplicity claimed for the original cost method, as the

ascertainment of a fact. All of the common controversial issues are present such as depreciation, going value, the valuation of lands, working capital and similar matters, and the accuracy of the reproduction estimates, as well as the relationship of the value determined to the actual investment.

3. The order is void because the findings of value are arbitrary and artificial.

The Commission's "value" rests on such radically inconsistent bases that the result defies definition. It is consistent with no theory or standard. The "value" found is not a value based on the *present* cost of reproduction, because it is largely based on *obsolete* costs. It is not a value on a *pre-war* standard. For the bulk of the property, 1914 prices were applied, and the Commission stoutly repudiates the use of present prices, but property acquired since 1914 is appraised at its high actual cost and the Commission appraises the land for the year 1923, for example, at the 1923 market values (R., 94). It is not a value based on a *complete* cost of reproduction sufficient to produce the property even in pre-war times, because depreciation has been deducted, the entire cost of acquiring the land is not included, and the cash working capital actually used is excluded. It is not the original cost of the property, because the original cost is unknown, because the method of determination eliminates certain well known elements of cost invariably incurred, and because the land is appraised as of 1920-3. It is not the true economic value of the property, because there is no attempt to reflect the real character of the railroad from the standpoint of its economic justifiability, since the Com-

mission values all railroads, good or bad, by the same formula. As disclosed in the opinion of Commissioner Potter in *Florida East Coast Railway*, 84 I. C. C. 25, 41, the same formula has been used for practically all of the railroads, at least for the first 330 appraised by the Commission. The Commission indicates that it has followed the same general method (R., 71). The "value," therefore, is purely artificial. It is an arbitrary figure responding to no rational test, and if productive of a right result, it is by accident and not because of any rule of reason. There is no presumption that the result by mere chance is correct. *Louisville and Nashville* v. *Greene*, 244 U. S. 522, 554; *Pennsylvania Railroad Co.* v. *Jacoby*, 242 U. S. 89, 99.

4. In the last analysis the order of the Commission may be supported only on the theory that the Commission is at liberty to adopt any basis for the determination of value that suits its convenience or its conceptions of supposed economic expediency.

In essence the position of the Commission is thus revealed to be that it should be undisturbed in its right to fix an aggregate sum for all the railroad property in the country, which is sometimes called "value," and sometimes approximate "investment," which is neither, and which is thought desirable because it will produce a predetermined standard of rates. The "value" thus justified responds to no single theory or principle, and cannot even be logically defined. This conception of "value" is consistent only with the theory that the Commission, unrestrained either by the Constitution or the courts, may arrive at that sum upon which the railroads should be

permitted to earn a fair rate of return under the Commission's particular conception of what that return shall be, and by calling such a sum "value," make it so. There can be no constitutional protection under this theory. This claim by the legislative agencies for dominion over the public utilities, unhampered by constitutional restraints, has been frequently condemned by this Court. It was to such a demand that the Court referred in the *Minnesota Rate Cases, supra*, page 434: "But the State has not seen fit to undertake the service itself; and the private property embarked in it is not placed at the mercy of *legislative caprice*."

VIII.

THE COURT BELOW ERRED IN HOLDING THAT APPELLANTS,—ALTHOUGH FOUND BY THE COMMISSION AND HELD BY THE COURT TO BE "A GROUP OF CARRIERS UNDER COMMON CONTROL AND MANAGEMENT,"—WERE NOT "OPERATED AS A SINGLE SYSTEM."

Appellants contend that the District Court and the Commission misconstrued the Act, and also failed to give proper legal effect to the undisputed evidence. It is therefor appropriate to consider first,

1. The meaning of the Act.

Since the statute is new, and its subject matter both novel and unusual, and since this is the first case in which this Court has been asked to construe under this statute the words "operated as a single system," we feel justified in discussing this subject at some length.

The provision immediately applicable is the following in paragraph (6) of Section 15a:

> "For the purposes of this paragraph the value of the railway property and the net railway operating income of *a group* of carriers, *which the Commission finds are under common control and management and are operated as a single system*, shall be computed *for the system as a whole irrespective of the separate ownership and accounting returns* of the various *parts* of such system" (italics ours).

To interpret this provision, it is necessary to have in mind the general nature and purpose of Section 15a (the Recapture Act).

(a) Its general purpose is to grant constructive benefits to the carriers.

This purpose was explained in *Dayton-Goose Creek R. Co. v. U. S.*, 263 U. S. 456, at 478, as follows (italics ours):

> "The Transportation Act adds a new and important object to previous interstate commerce legislation. * * * The new act seeks affirmatively *to build up a system of railways* prepared to handle promptly *all the interstate traffic* of the country. It aims *to give the owners of the railways* an opportunity *to earn enough to maintain their properties and equipment* in *such a state of efficiency* that they *can carry well this burden.*"

Supplementing that part of the constructive plan of Congress by which the railways of the United States are to be consolidated into a limited number of systems (Section 5, paragraph 4 of the Interstate Commerce Act, 41 Stat. L. 481), and to avoid a consequent unjust discrimination against railways not parties to such consolidations, Congress included all railways within its constructive plan by requiring rate readjustments for the railways as a whole, or as a whole in each rate group or territory into which the Commission was to divide them.

The special purpose of the recapture part of this plan was explained thus in the *Dayton-Goose Creek* case (*supra*, 263 U. S. 456 at 479):

> "The directions given to the Commission in fixing uniform rates will tend to put them on a scale

enabling a railroad of average efficiency among all the carriers of the section to earn the prescribed maximum return. *Those who earn more must hold one-half of the excess* primarily *to preserve their sound economic condition* and avoid wasteful expenditures and unwise dividends. *Those who earn less* are *to be given help* by credit secured *through a fund made up of the other half of the excess.* By the recapture clauses Congress is enabled *to maintain uniform rates* for all shippers and yet *keep the net returns* of railways, whether strong or weak, *to the varying percentages which are fair* respectively for them. *The recapture clauses are thus the key provision* of the whole plan."

It thus appears that the purpose of the statute is to enable carriers *of weak earning power to build up their transportation facilities* out of *the revolving fund created by the excess income recaptured* from carriers *of strong earning power.* This beneficial purpose extends to *all* interstate carriers.

Treating the carriers *as a whole*, Section 15a seeks to effectuate this dominant purpose by directing the Commission to do certain things, each constituting an essential part of the plan, viz., *first*, to so *establish or adjust the rates* that the carriers, as a whole, or *as a whole in each rate group*, will, under proper management, *earn a fair return upon the aggregate value* of their properties; and *second*, when that has been done, and when the carriers have received *the benefit* (reflected in their "net railway operating income"), *of this readjusted rate structure, to apply the recapture provisions* by *taking from the high earning* carriers *one-half* of their *excess* income.

to be *placed in the revolving fund* for use *in building up the facilities of low earning carriers.*

This part of the plan, applies to the carriers *as a whole* no matter what may be their individual location or operating relations to other carriers.

(b) THE SAME HELPFUL PURPOSE IS EXTENDED TO SMALLER GROUPS OF CARRIERS, BUT THROUGH A DIFFERENT AND MORE EFFECTIVE METHOD.

This expressed purpose, to give financial aid to the carriers, is also clearly intended *to apply to smaller groups of carriers* that "are under common control and management and are operated as a single system."

This purpose of the Act in respect of such smaller groups of carriers, is in harmony with its general purposes as construed in the *Dayton-Goose Creek* case (263 U. S. 456, at 478-479).

Congress knew that in administering Section 15a, the Commission would encounter numerous systems of carriers in which some of the members or "parts *of such system*" would be *financially weaker* than *others.*

The weaker members of these systems were as much a matter of concern as other weak roads. To them the helpful purpose also applied.

But *the special method by which the weaker parts* of such a group *were to receive the benefit of the excess income of stronger parts,* was so designed as to be particularly important here.

Instead of requiring *one-half,* or *any other proportion,* of the excess income of the prosperous members of such a group, *to be paid into "the revolving fund,"* for the gen-

eral benefit of *all the carriers throughout the United States*, a much more direct and effective method was provided. This method proceeded necessarily upon the assumption that such a group—all being owned by and financed out of a *common pocketbook*, (evidenced by "common control and management"), *and operated as a single system*—could be most effectively aided *by leaving within the common pocketbook, the excess income of the stronger members*.

This assumption was obviously sound. It expressed a preference for directly effective rather than devious and uncertain, methods of relief.

The Act was not intended to be used to recover *for the benefit of the United States, as much of the excess* income *of each carrier, "as the traffic would bear."* It was not a taxing act *to obtain revenue for the United States* (*New England Divisions Case*, 261 U. S. 184).

On the contrary, it presented a constructive plan of relief and improvement. To this end, the Act made very clear, the intent to deal *liberally (constructively)* with *family groups* or *"systems"* of carriers.

Accordingly, Congress provided that the Commission *"shall,"* in respect of recapture, treat each such family group *as "a whole* irrespective of *the separate ownership and accounting returns* of the *various parts* of such *system."*

From the words "irrespective of the *separate ownership* and *accounting returns* of the various parts of such system," it appears that Congress intended that single system treatment be accorded to such groups, even though their respective properties might be *owned* by separate corporations. The Congress knew, that although a part

of a single system, each such corporation was required by the Commerce Act, to make separate accounting returns to the Commission. Common *ownership* was not required. Common *"control,"* common *"management"* and *"system operation"* were deemed sufficient as the requirements for single system treatment.

Congress clearly intended: that the Commission should look through matters of form and grant the benefit of single system treatment whenever the essential nature of the relations between the different parts of such a group was in accord with the fundamental purpose of the Act; and that in administering the Act, the Commission should give it a liberal—not a strict, harsh, or technical—interpretation. But, appellants contend that neither the Commission nor the District Court so interpreted or applied the Act. Instead of so doing, they dealt with this group of carriers in a harsh and arbitrary manner, *contrary to the plain purpose* of the Act.

Neither the majority Report of the Commission, nor the Opinion of the District Court, took any cognizance of the necessity of construing liberally subdivision (6) of Section 15a in aid of the constructive and beneficial purpose of the Act, to permit family groups of carriers to build themselves up financially out of the excess income of the high-earning members where possible, rather than by resorting to the general contingent fund.

Only the dissenting opinion of Commissioner Taylor (R., 101) recognized this necessity.

(c) CONGRESS ALSO INTENDED TO GRANT TO EACH GROUP UNDER COMMON CONTROL AND MANAGEMENT AND OPERATED AS A SINGLE SYSTEM, THE SUBSTANTIVE RIGHT TO SINGLE SYSTEM TREATMENT. IT DID NOT INTEND SUCH TREATMENT TO BE A MATTER OF MERE GRACE, RESTING WITHIN THE DISCRETION OR CAPRICE OF THE COMMISSION.

Appellants contend that under the Act, a group of carriers acquires the *substantive right* to be treated as a single system for recapture purposes, *whenever in fact and law it is "under common control," etc.*

"Common control" assumes the existence of *either common ownership* or such *community in respect of ownership as to result* in "common control and management,"—a meaning more liberal in scope than would have resulted had the words "common ownership" been used.

Congress evidently had in mind that the same pocketbook might both *control* and *manage* railroad properties, the "operation" of which does not resemble that of a single system.

Since a part of the Congressional purpose was to build up various transportation "systems," it is obvious that unit treatment of any particular group of commonly controlled and managed carriers would not tend to accomplish this purpose unless *the properties of the members of the group were operated together as a single operating system.*

But when such a group is so operated within the true intent of the Act, then appellants contend that the carriers have a *substantive right* to single system treatment, and that this right cannot be denied by the Commission at its discretion or caprice.

In the District Court the United States contended (R., 132), that the "finding" of the Commission that petitioners were not operated as a single system was final, not subject to judicial review.

This contention if sustained would have placed the enjoyment of this substantive right at the uncontrolled discretion and caprice of the Commission. It would have violated the constitutional limitation on the exercise of all power "where rights depend upon facts," (*I. C. C.* v. *L. & N. R. Co.*, 227 U. S. 88 at 91), and would have run counter to the authority of the *Chicago Junction* case (264 U. S. 258 at 264, also footnote at 265), which construed the analogous expression "whenever the Commission is *of opinion*, after hearing," etc.

This contention, the District Court overruled, (R., 132-133), and appellees have not included the point in their Assignment of Errors (R., 163-165), nor in their Points (R., 656-657).

Both the District Court and the Commission found and held in respect of these two carriers,—that they "are under common control and management," but that they are not "operated as a single system." Therefore single system treatment was denied them.

The evidence before the Commission and Court was undisputed. Therefore, this entire case in respect of single system treatment turns upon the issue of law, whether upon undisputed facts these two railroad properties were operated as "a single system" within the meaning of Section 15a.

Appellants respectfully contend that the District Court and the Commission erred, (1) not only in giving the Act a strict rather than a liberal construction, but also in their

construction of the statutory expression "operated as a single system," and (2) in reaching conclusions of fact, treated as controlling, which were contrary to the undisputed evidence and without supporting evidence.

2. The undisputed facts before the Commission on the question of single system operation.

A reasonably complete picture is necessary to an adequate consideration of the points at issue.

(a) DESCRIPTION AND LOCATION OF THE PROPERTIES.

(1) *The O'Fallon* is an Illinois railroad corporation (R., 295), organized June 1, 1896, under the general laws of Illinois (R., 543). It owns and operates about nine miles of main line and about eleven miles of yard track and sidings in Illinois (R., 544). Its main line extends westward from the coal mines of the "St. Louis & O'Fallon Coal Company," owned by the Estate of Adolphus Busch (R., 543-544, 297), to East St. Louis, where it connects with the tracks of a subsidiary of the Terminal Railroad Association. Near its eastern terminus the O'Fallon has track connection with an electric line (the East St. Louis & Suburban Railway), from which it receives for transportation westward to East St. Louis, and for delivery there to connecting lines, the coal output of two mines (the "Prairie" and "St. Ellen," not "Busch" mines), located on this electric line (R., 309).

At East St. Louis, the O'Fallon also connects for the interchange of business, with the Southern Railway Company and with the Alton and Southern Railroad (R., 544). The "Alton and Southern" is an independently

built line having physical connections with all lines in the East St. Louis district except the Wabash, Clover Leaf and Southern (R., 375). Through its interchange connections with the Terminal, the O'Fallon reaches all the lines in the St. Louis-East St. Louis terminal district (R., 445).

After having been owned by several prior owners, the O'Fallon was acquired by Adolphus Busch on September 15, 1913 (R., 298). His purpose in acquiring it will be stated later.

A map of the O'Fallon appears at Record pages 514-515.

(2) *The Manufacturers* is a Missouri railroad corporation (R., 295), dating back to 1887 (R., 298). It was originally designed to afford improved shipping facilities to the Anheuser-Busch industries in South St. Louis (R., 299).

During two ten-year periods from 1887 the Manufacturers' line was leased to and operated by the Missouri Pacific. At the end of the second lease term the property was taken over and operated by the Manufacturers itself (R., 299). Its operated lines consist of about thirty miles of track, in St. Louis, of which 5.22 miles are main line tracks, 13.45 miles are yard tracks and sidings owned by the carrier, 5.15 miles are leased by the carrier, and the balance is trackage owned by served industries (R., 372).

A large blue-print map of the Manufacturers' lines is included within "Petitioners' Exhibit 3," as Wright Exhibit No. 6 thereto (R., 312). Under order of the District Court made pursuant to Rule 9, paragraph 3, of this

Court, said entire Exhibit 3 including this map, is lodged with the Clerk of this Court, for inspection.

This map shows an elaborate system of main lines and subordinate tracks extending in St. Louis from Poplar Street on the North to about Potomac Street on the South, with numerous spurs, sidetracks, switches and public team tracks, with extensive classification yards and distribution facilities, and with facilities for interchange with the Missouri Pacific and also with the St. Louis Transfer Railway, a subsidiary in St. Louis, of the Terminal.

(b) COMMON OWNERSHIP AND CONTROL; FINANCIAL CONDITION.

There is almost complete common ownership and control of these two carriers (R., 291), in the Estate of Adolphus Busch, and members of his family (R., 292).

The O'Fallon has seven directors, the Manufacturers five. Three members of the O'Fallon Board are also members (a majority) of the Manufacturers' Board (R., 292).

Financially, the O'Fallon is strong, the Manufacturers weak (R., 378). The O'Fallon, since its acquisition by Adolphus Busch, has paid large dividends (R., 507, 589), and in addition has paid off $136,000 of mortgage bonds, and increased its surplus by $413,151.31 (R., 588).

For more than ten years prior to October, 1922, the owners of the Manufacturers "had received no returns on the value of the property." And the Commission found that during the recapture periods it had no excess net operating income subject to recapture (R., 83).

(c) THE PURPOSE OF ADOLPHUS BUSCH IN EXPANDING AND DEVELOPING THE MANUFACTURERS FROM A "PLANT FACILITY" (R., 299), INTO A GENERAL SWITCHING AND TERMINAL COMMON CARRIER (R., 438; 21 I. C. C. 304), AND IN ACQUIRING THE O'FALLON.

The purpose of the controlling owner (Adolphus Busch) in developing the Manufacturers was to establish an independent competitive terminal railway in the City of St. Louis (R., 377-378), and the Report of the Commission so states (R., 45).

His primary purpose in acquiring the O'Fallon, was "the combining of the two properties and the establishment, in accordance with" his "promise to the City of St. Louis and in furtherance of his own personal plans, of competition across the Mississippi River" (R., 298).

The competition in cross river transportation thus referred to, meant competition with the Terminal Railroad Association of St. Louis.

In taking charge of the two properties after the death of Adolphus Busch, William Cotter, the new President, was informed of this purpose by August A. Busch, son of Adolphus Busch and Chairman of the Board of both companies, and it was decided not to abandon this purpose by selling the properties, but to continue it by retaining and developing them (R., 377-378).

The Manufacturers presents "the only possibility of building up a competitor of the Terminal" (R., 422).

By Act of Congress, June 25, 1906 (34 Stat. 467), the City of St. Louis was authorized to construct, maintain and operate a railroad, wagon and foot passenger bridge and approaches thereto, across the Mississippi

River at St. Louis. At the time of taking evidence before the Commission, this municipal bridge had been built, rails had been installed on the bridge proper, and a municipal bond issue had been authorized with which to complete the south rail approach on the Missouri side (R., 292). The completion of this approach to the municipal bridge will enable the Manufacturers in connection with the Alton and Southern, to handle a very substantial cross-river business, both eastbound and westbound, that is now handled through the Terminal (R. 375). The municipal bridge is in the southern part of St. Louis. It opens up an entire new avenue for the handling of traffic. It will practically revolutionize interchanges of business in the St. Louis terminals (R., 376).

For the purpose of physically connecting the rails of the Manufacturers and the O'Fallon, the latter has acquired and owns about thirty acres of land at the eastern end of the municipal bridge. This land was purchased and is held for the purpose of making a direct connection between these roads as soon as the municipal bridge is opened for railroad use (R., 292).

(d) THE NATURE OF THE TRANSPORTATION SERVICE RENDERED BY THE APPELLANTS, THEIR RELATIONS WITH THE TERMINAL AND WITH EACH OTHER, AND THE FACTS CONCERNING "UNITY" (R., 45) IN OPERATING THEM.

(1) *Nature of service.*

The O'Fallon: The service performed by the O'Fallon is that of a *line-haul carrier*. It is classified by the Commission as a "Class 2 Steam Road" (R., 456). It is engaged almost exclusively in the transportation of coal

(R., 295) that originates partly from mines located on its own line (R., 374), and partly from mines located on the East St. Louis and Suburban Electric line. All of this coal it transports westwardly into East St. Louis, where it is delivered to connecting lines (R., 309). At least ninety-nine per cent. of the total traffic of the O'Fallon consists of coal (R., 299). There are one or two other industries located on the O'Fallon (R., 381); one of them ships brick and shale (R., 438).

There is some eastbound business over the O'Fallon, consisting of supplies used in coal mining operations (R., 374), moving to the mines. Except for this, the outbound business from East St. Louis to the mines is practically negligible (R., 295). During 1923, the O'Fallon also carried eastward, for state road construction, a large quantity of roadway materials that had originated partly in East St. Louis and partly in St. Louis and elsewhere (R., 295).

Of the coal transported westward by the O'Fallon, some is delivered in East St. Louis, some in St. Louis, some goes west and some northwest from St. Louis (R., 296).

An exhibit (R., 590), shows more than 400,000 tons of coal received by the O'Fallon from the Suburban Electric line and transported into East St. Louis during the period from August, 1922, to July 13, 1923. It was destined to various points in and near East St. Louis, and more than 321,000 tons to points in Missouri near but outside of St. Louis. As to the coal originating on and transported by the O'Fallon, there is a very large trade with industries and coal retailers in St. Louis and East St. Louis (R., 433).

The evidence before the Commission contained no complete showing of the total coal tonnage transported by the O'Fallon during either of the recapture periods, but in addition to the above illustrative exhibit (R., 590), the evidence showed that "at times, particularly during the period of the war, the O'Fallon transported a little over 20 per cent. of all the coal that came into the St. Louis terminals."

The Manufacturers: It is purely a "Switching and Terminal Class 3" road (R., 294), and is so classified by the Commission (R., 456). The great bulk of the Manufacturers' business is the switching "(interchange)" of cars for the connecting trunk lines (R., 297). It serves 332 industries in St. Louis and handles about 50,000 loaded cars yearly, (R., 310, 372).

(2) *Transportation relations between the O'Fallon and Manufacturers.*

"There is existing a steady movement of coal from mines on the O'Fallon to industries on the Manufacturers" (R., 295). A "very large percentage of coal" is handled on the Manufacturers, a great deal of which comes from the O'Fallon (R., 297, 443).

The record before the Commission contains no showing of the total coal carried from the O'Fallon mines to consignees on the Manufacturers during the whole of any recapture year, but there is an exhibit (R., 639-642) showing such movements during one month (August) in the summer of 1924. It shows a total of 222 such cars of coal.

As to coal originating on the O'Fallon, there is a very large trade with industries and coal retailers in St. Louis (R., 433).

There is no steady movement of traffic from the Manufacturers to the O'Fallon (R., 374). There naturally would not be. The large majority of industries on the Manufacturers are manufacturing plants; their commodities are moving out (R., 374). Occasionally something from the Manufacturers goes to the O'Fallon; very little.

Any shipment of coal consigned from the O'Fallon to any of the industries on the Manufacturers is billed by the O'Fallon, and moves under that billing over the rails of the O'Fallon and the intervening rails of the Terminal and is delivered to the Manufacturers, which in turn transports it to the point of destination on its line, and there delivers it to the consignee (R., 295). The Manufacturers gets the cars originating on the O'Fallon from the Terminal in train lots and breaks up the trains before they are transported over the Manufacturers. The cars are then switched and classified. That is the general practice with all railroads (R., 445). The classification yard of the Manufacturers at Dorcas Street has a capacity of approximately 5,000 cars on twelve tracks (R., 311).

In respect of through routes, rates, divisions and tariffs, the O'Fallon is treated by the trunk lines as a participating line haul carrier receiving divisions of rates, (R., 293, 295, 296, 441), whereas the Manufacturers is treated as a switching and terminal carrier, receiving out of the common "St. Louis rates" a switching or terminal allowance that is absorbed by the line haul carriers, (R., 293-295), including the O'Fallon (R., 296).

(3) *The Terminal's part in the through transportation between the O'Fallon and Manufacturers.*

There is no direct physical connection between the rails of the O'Fallon and those of the Manufacturers, except by the rails and bridges of the Terminal (R., 292) or of its subsidiaries, with one of which (the Illinois Transfer Railroad) the O'Fallon connects and interchanges at East St. Louis (R., 568), and with the other of which (the St. Louis Transfer Railway), the Manufacturers connects in the southern part of St. Louis (R., 299).

The physical gap between the rails of the O'Fallon and those of the Manufacturers,—about twelve miles,—is filled by the rails and two cross river bridges (the "Eads" and "Merchants"), belonging to the Terminal (R., 294).

The O'Fallon and Manufacturers possess (and so claimed before the Commission) (R., 292, 294, 300),—also in the District Court (R., 135),—the right (under a decree directed by this Court in *U. S. v. Terminal R. R. Assn.*, 224 U. S. 383; *Terminal R. R. Assn. v. U. S.*, 266 U. S. 17,) to treat and use the facilities of the Terminal as their own, and the Terminal as their "servant or agent," and so to run trains, engines and crews through from the O'Fallon to the Manufacturers and *vice versa*, over the Terminal's said facilities, and this right is exercised "whenever desired" (R., 292). It has been exercised during at least eleven years (R., 296, 299) since 1912. Its exercise varies according to traffic conditions, mostly depending: upon the movement of coal, particularly during the winter months; upon local conditions in the Terminal; and the rapidity with which business is moving (R., 295).

The Terminal makes a practice of permitting lines (about nine of them) that are not among its proprietors, to operate over the facilities of the Terminal (R., 296); and several of the lines do so (R., 294). It was not much used by these two carriers during the last two years (1922-3), primarily because the coal traffic has not been forty per cent. of normal. At times, particularly during the war (R., 299), these two carriers were "very active" in handling trains from the O'Fallon to the Manufacturers (R., 300). The exercise of this claimed right involved the employment of a pilot (R., 294). The O'Fallon and Manufacturers would not profit financially by any greater use of the Terminal's said facilities than they would by letting the coal be handled by the Terminal as a participating carrier over its own intervening facilities (R., 300).

"The Terminal is an intermediate line acting for and on behalf of all the lines of the St. Louis-East St. Louis terminal" (R., 445). It "usually" acts in this capacity as to the traffic between the O'Fallon and the Manufacturers (R., 296). There is a steady movement of coal over the rails of the O'Fallon and the intervening rails of the Terminal, to industries on the Manufacturers (R., 295). The Terminal delivers the O'Fallon cars to the Manufacturers in the same way that it delivers cars from all the trunk lines. There is no service for the O'Fallon by the Manufacturers that differs in any respect from the service it renders to the trunk lines that make delivery through the Terminal (R., 445). The trunk lines, except the Missouri Pacific, do not make deliveries to the Manufacturers. About twenty-six lines in addition to the O'Fallon make deliveries through the Terminal (R., 444).

In the division of rates the line haul carrier to East St. Louis gets a larger division if the delivery is at a point on the rails of the Terminal, than it gets if the delivery is at a point on the rails of some other carrier and the Terminal is an intermediate carrier, though the rate paid by the shipper is the same (R., 293). The same is true as to shipments to or from St. Louis over the trunk lines, which absorb (out of the St. Louis rate) the switching charges of the Terminal and of the other terminal carrier (if any) upon whose rails the shipment originates or is delivered (R., 293).

(4) *Single System Operation.*

In addition to the facts above stated showing unity of ownership, control, purpose, and management, the record before the Commission shows that if these properties had been owned and operated together by the same corporation, the method of single system "operation" would not have differed in any way except that in such case the accounting and reports would have been for one carrier, not two.

The operation of both properties is immediately under the direction of the same man (Mr. A. E. Wright), who is Assistant to the President in both companies (R., 291). The offices are common to both companies (R., 292). All of the officers and all of the general employees, from President to office boy, are common to both (R., 292; 442-443). The work interlocks in nearly all departments; the office work for both companies is carried on in the same office by the same people. The same is true as to the accounting and bookkeeping department, the car accounting depart-

ment, the purchasing agent, the executive and operating departments, the traffic department, the engineering department, the transportation department, and to a large extent the mechanical force (R., 442; 638-639). The accounting records, though kept by the same employees, are kept separate because the Commission so requires (R., 442-443).

The man who attends to the traffic of the Manufacturers, also attends to the traffic of the O'Fallon, and is paid by both companies (R., 443).

The engine repair shop for both companies is on the Manufacturers, in St. Louis. The car repair shop for both is on the O'Fallon in East St. Louis (R., 292). Repair work done in either such shop is charged to the carrier for which it was done (R., 443). A great deal of locomotive repair work is done for other railroads (R., 444). Each employee who works for both companies gets a salary check from each company for his services to it (R., 442). The train and engine employees are carried on the pay roll of the company to whose work they are assigned, but when crews run through from one road to the other, their compensation is pro rated on the basis of the services performed (R., 292).

Mr. A. E. Wright, who operated both properties during each of the recapture periods, testified (R., 441-442) that he had operated them as a single system in respect of all their activities and of the management of all their employees (R., 442). Mr. Cotter, President of both companies, testified that he treated the two properties as one properties, they had been operated as one (R., 380). Mr. —that during the ten years of his connection with the

August Busch, Chairman of the Boards, and an owner, regards them as one property (R., 407).

If the two lines were a single corporate entity, the system operation would be in no way different than it is and was during the recapture periods (R., 294), except as to the accounting records and reports which would then be made for only one corporation.

3. The erroneous finding and rulings of the District Court, and of the Commission, upon the basis of which they denied the right of appellants to single system treatment. Appellants contentions and argument.

In stating each point as to which appellants contend there was error, the grounds for such contention will also be stated and argued.

(a) THE CONCLUSION OF THE COMMISSION AND COURT, ON "SINGLE SYSTEM OPERATION" WAS BASED ON AN ERRONEOUS INTERPRETATION OF THE STATUTORY EXPRESSION "OPERATED AS A SINGLE SYSTEM."

The Commission and the District Court, although finding that there was common ownership (R., 43) and "common control and management," found and held that there was not "single system *operation*" (R., 45-46), and therefore denied to appellants their claimed right to single system treatment.

This conclusion of the Commission, adopted in effect by the Court, (R., 135-136), was made to rest on an interpretation of the Act, (a) as giving to the word "operated" a meaning far beyond its ordinary meaning in railroad

parlance, and (*b*) as requiring "unity of *purpose*" in the "operation" of the properties (R., 45).

Appellants contend that in each of these respects, the Commission's interpretation was erroneous.

As to the word "operated," appellants contend that the established rule of construction, by which words are (unless some other intent is expressed in the Statute) to be given their "ordinary" meaning, should be applied in construing the expression "are *operated* as a single system."

The word "operated" as applied to railroad property has a commonly accepted meaning that relates to their mechanical operation or functioning. Every railroad has an "operating department" with "operating" officials, staff and employees, distinct from its accounting, traffic and other conventional "departments."

Illustrations of this meaning will be found in the numerous cases interpreting state statutes that impose or regulate liability for injuries to persons or property, occurring through the "operation" of railroads (see *C. M. & St. P. Ry.* v. *Artery*, 137 U. S. 507, at 511).

This fact in respect of railroad terminology was well known to Congress. It must, therefore, be assumed that in the enactment of paragraph (6) of Section 15a, and in prescribing the conditions necessary to the right of single system treatment, Congress intended the word "operated" to have its customary meaning in railroad parlance.

In requiring "common control" the Congressional intent had already dealt with the subject of common control,—whether or not predicated on common ownership. In requiring "common management," the Con-

gressional intent had dealt with an additional subject that included within its scope such departments as handle executive policies, finances, relations with shippers, traffic relations with other carriers, etc., but do not, in railroad parlance, include "operating" the properties. Therefore, it seems necessary to conclude that by also requiring that the properties shall be "operated" as a single system, Congress merely intended that their mechanical operation or functioning shall be substantially the same as they would have been if owned by the same corporation and operated as a single "operating" unit.

This construction of the Act is not only simple and plain from the words used, but is also in harmony with Congress' liberal intent toward the carriers.

In its interpretation of the expression "operated as a single system," as requiring "unity of *purpose*" in the "operation" of the properties, the Commission erred further, because the Act plainly means that when common ownership, control and management exist, the right to single system treatment does not then depend on the "*purpose*" for which the properties are *operated*.

It depends on whether the actual "operation" of the properties is substantially the same as it would have been had they been part of a system or group operated together as though an operating unit.

Appellants contend that this test alone is all that the statute requires, and that the undisputed evidence here shows that there was such combined or "single system" *operation* of their properties.

But if the statute should be held to go further and to extend the meaning of the word "operated" beyond its

above ordinary meaning, and so as to also relate it to the kind of service of transportation in which the operating occurs, then appellants again contend that the right to single system treatment does not depend on the "purpose" but does depend on the effect or result of the operating.

If the essential nature of the combined transportation service that these two carriers perform—the service of one supplementing that of the other—results in a *unit of service* so that together they constitute "a chain of transportation," then (appellants contend) they are "operated" as a single system within the utmost possible meaning of the Act.

(b) THE GROUNDS ON WHICH THE DISTRICT COURT AND THE COMMISSION HELD AGAINST SINGLE SYSTEM OPERATION, ARE ERRONEOUS, BEING CONTRARY TO THE UNDISPUTED FACTS AND WITHOUT SUPPORTING EVIDENCE.

(1) *The Commission erroneously held that the "unity of purpose" which it interpreted the Act to require, did not exist under the evidence before it, partly because,*—while *"the purpose in developing the Manufacturers" was the establishment of an independent competitive terminal railway in the City of St. Louis,—"the purpose for which the O'Fallon was acquired" by the same owners "is not clear on the record"* (R., 45).

The opinion of the Court below contains no discussion of this legal theory of the Commission as to unity of "purpose" being required. But evidently the Court was in accord with it (R., 135).

Appellants respectfully contend that "the purpose for which" the controlling owner of the Manufacturers (Adol-

phus Busch) also acquired the O'Fallon was clear on the record. It was substantially the same purpose stated above for his "developing the Manufacturers," viz.: "The combining of the two properties and the establishment of competition across the Mississippi River, in accordance with his promise to the City of St. Louis" (R., 298).

The Commission evidently overlooked this definite and clear, uncontroverted testimony.

The fact (mentioned by the Court below, R., 135), that the two properties have not yet been physically connected in accordance with this purpose (because the Municipal Bridge approach has not yet been completed, R., 292), is immaterial here. Until such completion as well as thereafter, appellants have the right to use as their own, the intervening rails and bridges of the Terminal.

(2) *The Commission and the Court below erred in finding that "only a very small percentage of the traffic originating on the O'Fallon moves to points on the Manufacturers'"* (R., 45).

The District Court (R., 134) quoted this statement from the Report, and assuming it to be a fact, reasoned thus:

> "A mere *short gap in physical connection* might not be sufficient to prevent these carriers being regarded as 'a single system' within the statutory meaning. But *where such gap exists* and thereto is added the considerations that *there is no common traffic moving one way over the two carriers and only a small percentage the other way*, it is difficult to believe that the two are operated as the 'single system' *intended by the statute*" (R., 135).

The District Court based its final conclusion against the existence of single system operation, on two ultimate supposed facts, of which this was one, saying:

> "But *here* these two carriers *have no traffic carrying or operating unity* except for *the small amount of coal delivered to the Manufacturers* from the O'Fallon and *no financial interdependence*. Therefore, we think, *the Commission correctly held* these two carriers *not* to be '*operated* as a single system' within the meaning of this statute" (R., 136).

Appellants respectfully challenge the correctness of this statement, upon the facts that appear in the undisputed evidence before the Commission.

There seems to have been a complete misconception of the evidence on this point, as it appears in the record before the Commission, which shows: that the O'Fallon is engaged almost exclusively in the transportation of coal (R., 295, 299) which originates partly from mines located on its own line (R., 374), and partly from mines located on the electric line with which it connects (R., 299); that there is "a very large trade" with industries and coal dealers in St. Louis, in coal originating on the O'Fallon (R., 443); that "a very large percentage" of the traffic on the Manufacturers, consists of coal, "a great deal" of which comes from the O'Fallon (R., 297, 443); and that there is "a steady movement of coal" from mines on the O'Fallon to industries on the Manufacturers (R., 295).

The record before the Commission contains no proof of the total amount of coal originating at the mines on the O'Fallon, that moved during the whole of any recapture year to consignees located on the Manufacturers. There is, however, an exhibit (R., 639-642) showing the number

of such movements during one month (August) in the summer of 1924. It shows a total of 222 cars of coal. Obviously, coal movements during the hot midsummer month of August would represent the minimum, rather than a fair average, of monthly movements during the entire year. It is, therefore, a fair inference that the *average* monthly movements of coal from the mines on the O'Fallon to consignees on the Manufacturers substantially exceeded 222 cars.

Since there was "a constant flow" of such traffic, we respectfully submit that the record before the Commission indisputably proved, that there was a substantial and constant movement of coal "originating on the O'Fallon to points on the Manufacturers."

We can find no evidence in the record before the Commission or the Court below, that even tended to controvert the above facts.

Yet these uncontroverted facts were either overlooked or ignored by the Commission when it found as a fact that "*Only a very small percentage* of the traffic *originating* on *the O'Fallon* moves *to points on the Manufacturers*," and therefore held that these properties are not *operated* as a single system.

And in adopting the above finding and ruling, the District Court fell into the same error.

(3) *The Commission and the Court below erred in finding that "there is no common financial responsibility or intermingling* of financial obligations and *benefits* as between the two carriers" (R., 45).

The District Court expressed it thus:

> "Also, there is *no financial interdependence between them* so that the *low earnings of one* cor-

poration *can be aided or recouped by the other*" (R., 135, 136).

This erroneous finding was also treated by the Court as a controlling fact, preventing the granting of single system treatment.

We respectfully submit that this finding is erroneous because it is contrary to every reasonable inference of fact deducible from the undisputed evidence.

The Act itself (Section 15a, par. 6) expressly excludes the necessity of "common *ownership*," and grants the substantive right of single system treatment to any group of carriers that "are under common control and management and are operated as a single system • • • *irrespective of the separate ownership* and *accounting returns* of *the various parts* of such system."

The evidence upon this point is simple. Here are two separate carrier corporations, one an Illinois corporation, operating in and out of East St. Louis, on the east side of the Mississippi River, the other a Missouri corporation operating across the river in St. Louis. They are required by the Commission to make separate accounting returns. Each is required by law to account to its own stockholders for the financial results of its business. The "common pocketbook" is that of the common owner, the estate of Adolphus Busch, being the stockholder which owns the large control of both corporations.

In addition to the facts stated on page 120, *supra*, the record shows that the Manufacturers was developed and enlarged from a plant facility that originally connected the industries of the Anheuser-Busch Brewing Association with the Missouri Pacific (R., 299) into a terminal and switching carrier now serving 332 industries in South St. Louis (R., 310). And the map of the Manu-

facturers (a part of the record before the Commission, as "Petitioner's Exhibit 3," deposited in this Court for inspection, R., 281, 174-175), shows how extensive these developments were.

Appellants contend that the conclusion of fact is reasonable and necessary, that substantial financing had to be done for the Manufacturers, in order to accomplish these results. Since the record is silent as to who furnished this financial aid, and as to the amount furnished, we respectfully submit that the further conclusion is inevitable that the estate of Adolphus Busch, which, as owner of the O'Fallon, had so greatly prospered through its financial success, must have financed the needs of the Manufacturers.

Can it be said with reason, that there is "no financial interdependence" between these two carriers "*so that the low earnings of one* corporation can *be aided or recouped by the other,*"—when the undisputed facts are that the abundant cash dividends from the O'Fallon went into the pocket of the same owner, who of necessity had to provide the money needs of the Manufacturers?

Can it be contended with merit that the Manufacturers was not so financially dependent on the owner of the O'Fallon that the low earnings of the Manufacturers would be aided by the large dividends paid out of the high earnings of the O'Fallon?

Is it possible that the beneficent purposes of the Act may be frustrated as to these two carriers, constituting a single group, merely because neither carrier corporation *owned the stock* of the other, so that dividends paid by one corporation would pass into the treasury of the other?

Is it not more in accord with the purpose and intent of the Act to concede the right to "single system" treatment when to the fact of such ownership in common as this record shows, with its necessary implication of financial dependence upon the same owner, there is added the undisputed evidence of "common control" and "management" plus single system "operation," and (if that be necessary) "substantial traffic carrying unity"?

On this point Commissioner Taylor in his dissenting opinion (R., 100) said:

> "It seems to me both unjust and unreasonable that two dollars coming out of the same pocket to be invested in like business, one dollar on one side of the Mississippi River and one dollar directly on the other side, should be so treated that the excess earnings of one of these units of value should not be permitted to offset the deficit in the earnings of the other."

We respectfully submit that the District Court erred in holding that there was no financial interdependence of the kind above mentioned, and in denying, partly on this ground, the appellants' substantive right to "single system" treatment.

(4) *The District Court and the Commission erred in holding that these two railroads are not "operated as a single system,"—have no "operating unity."*

Since all that the expression "operated as a single system" means, is a mechanical functioning of the two properties together substantially as though they were parts of the same system, there can be no doubt that there was such operation.

The undisputed facts have already been stated (see pp. 48-49) and will not be repeated here. They conclusively support the statement of A. E. Wright, who operated both properties during each of the recapture periods (R., 294), that "If the Manufacturers and the O'Fallon were a single corporate entity, the system operation would be in no way whatsoever any different than it is today and has been during the recapture periods. I know of no change that could be made."

Appellants respectfully submit that no feature can possibly be suggested in respect of the "operation" of these properties that would differentiate such "operation" from that of a single system, and since it is "operation" similar to that of single system "operation", that the Statute requires, appellants are entitled to single system treatment, because the "operation" of these properties was similar to that of a single system.

But the words "operated as a single system" were here given a meaning broader in scope than its above ordinary meaning in railroad parlance, and were held to require such operation of both properties in respect of their combined service of transportation as to render them a single transportation unit. In so holding the Commission reasoned thus:

> *They do not form "a chain of interstate transportation,"* but *"are separated by twelve miles of tracks of other railroads* over which these carriers *have no control,"* and *"neither is necessary to the other"* (R., 45, 46); and,

A "System", within the meaning of the Act "is something which is *complete in itself*, each part

complementing the other parts to make up the whole,"—whereas—these two roads, *being physically separated* by twelve miles of the tracks of *other* railroads *not controlled* by these two, have *no such complementary relation* as *component parts of "a single whole."* "They could as well be a thousand miles apart" (R., 46).

The Court below adopted substantially the same reasoning (R., 135, 136).

Assuming for argument that the word "operated" not only means the mechanical functioning of the properties, but also refers to the kind of transportation or "traffic carrying" service performed, appellants contend that even as so construed by the District Court and the Commission, there was single system operation, and that the conclusion *contra* is erroneous because contrary to, and unsupported by the undisputed facts.

This conclusion,—that there is "no traffic carrying or operating unity *except* for *the small amount* of coal delivered to the Manufacturers' from the O'Fallon" (R., 136), has already been shown to have been completely erroneous in fact as to the amount of such coal movements.

With the correct fact in mind,—that there is a steady movement of such coal in substantial quantities,—there remain for discussion the two additional erroneous conclusions: that these is "no traffic carrying unity" in that these two carriers do not form "a chain of interstate transportation complete within itself, each part complementing the other to make up the whole"; and that the physical gap of about twelve miles, between their rails,

is not bridged by their right to use the facilities of the Terminal.

First—The Court and Commission erred in holding that there was no "traffic carrying unity." Appellants contend that the *line-haul* service of the O'Fallon carries the coal to the E. St. Louis-St. Louis Terminal district,—the gateway of the coal market in St. Louis; and that the *switching and terminal* service of the Manufacturers receives the coal at this gateway in train lots, and thereupon supplements the transportation service of the O'Fallon, by breaking up the trains, by switching and classifying the cars for convenient and effective deliveries, and then by transporting the cars to their respective destination points on the Manufacturers and by there making delivery of them to the consignees.

The combined service of these two carriers thus constitutes a unit of transportation service. It differs in no respect from the similar service performed by every other railroad that carries into East St. Louis coal destined to consignees in St. Louis. As to such other coal roads their service of *line haul* transportation is *supplemented* and *must be supplemented* by the *switching and terminal* service *in St. Louis* of the Terminal, or of the Manufacturers, or of the Terminal plus that of such other carrier in St. Louis as performs the terminal service necessary to deliver the coal to its consignee at the designated point of delivery.

The O'Fallon *needs* and *must have* this supplementary service of the Manufacturers, in order that the interstate shipments of coal originating on its line and on the electric line with which it connects, may be transported and delivered to consignees located on the Manufacturers.

The Manufacturers *needs* and *must have* this initial transportation service of the O'Fallon, in order that industries and coal dealers located on the Manufacturers—being purchasers of "O'Fallon" coal, or of "Prairie" or "St. Ellen" coal,—may obtain a complete service of transportation from the mines to the designated points of delivery on the Manufacturers.

These two carriers do therefore, contrary to the conclusion of the Commission (R., 45, 46), constitute *"a chain of interstate transportation,"* a *"unit of transportation service."* They are "component parts of a single whole" (R., 146) in respect of the essential nature of the transportation service performed.

In support of its ruling on this point, the Commission states (R., 45), that in the *Eichenberg case* (14 I. C. C. 250), the Commission found that the Southern Pacific Terminal Company, at Galveston, "was *a part* of the Southern *Pacific 'System,' because* 'it *forms a link in this chain of interstate transportation.* It is *necessary* to *complete the avenue through which move shipments* over these lines *owned by a single corporation.*'"

The *Eichenberg* case did not involve a question of single-system operation under the Recapture Act, but did involve the question whether for purposes of transportation, the Southern Pacific Terminal Company, which owned docks at Galveston, was a part of the Southern Pacific system, and therefore *subject* to the Interstate Commerce Act. The Commission held that it was a part of the system because the terminal service of the Southern Pacific Terminal Company *supplemented the transportation service* rendered by the other links in the Southern Pacific "system."

The Commission's report (R., 45) also quotes from the opinion of this Court in *So. Pac. Terminal Co.* v. *I. C. C.*, 219 U. S. 498, at 523 (which involved the same question), as follows (Italics ours):

> "The record does not present a case of stock ownership merely or of a holding company which was content to hold. It presents a case, as we have already said, of one *actively managing* and *uniting the railroads and the Terminal Company* into *an organized system*. And it is with the system that the law must deal, not with its elements. Such elements may, indeed, be regarded from some standpoints as legal entities; *may have*, in a sense, *separate corporate operation*; but *they are directed by the same paramount and combining power and made single by it*. In all transactions it is treated as single. • • • it is the system which is dealt with and not its separate links."

But, notwithstanding the fact that by undisputed evidence in this O'Fallon case, it appeared that the Manufacturers *was at least as "necessary"* as the Southern Pacific Terminal Company, as *"a link in this chain of interstate transportation"* to *"complete the avenue* through which move shipments over these lines owned by" *a common owner*, the Commission *refused to apply a like rule* to the appellants, who respectfully submit that the above Southern Pacific decision is an authority for them, not against them.

Second—Both the District Court and the Commission erred in not according to the decisions of this Court in the "Terminal" cases their necessary effect as conclusively holding that there was no "gap" between the respective

transportation services rendered by appellants. It was contended for the appellants (Petition, R., 11, 12; Opinion, R., 135), and is contended here, that the facilities and service of the Terminal, *covering the twelve-mile gap* that intervenes between the rails of the O'Fallon and those of the Manufacturers, were and are available to appellants for use by them either (a) to operate their own trains thereover with the same effect as though extensions of their own rails; or (b) to have the intervening operations performed by the Terminal's locomotives and crews, as the agent or servant of the appellants.

This right was and is claimed by appellants to exist because of the decree directed by this Court, as shown in *U. S.* v. *Terminal R. R. Assn.*, 224 U. S. 383, at 411; *U. S.* v. *Terminal*, 236 U. S. 194; and *Terminal* v. *U. S.*, 266 U. S. 17, at 23, 24.

A certified copy of this decree was offered in evidence by Appellants in the District Court (R., 278), but excluded, and exception noted (R., 286).

While this ruling was error, the nature of the decree sufficiently appears from the opinions of this Court in the above Terminal cases.

The majority Report of the Commission did not mention this important point. The District Court considered it (R., 135-136), but did not give to the opinions or decree their correct or complete legal effect.

Appellants respectfully contend that the District Court misunderstood the legal effect of these decisions, and so erred in its application of them to the undisputed facts here.

The undisputed evidence on this point, as shown by the record before the Commission has been stated (see pp. 45-48), and will not be repeated here.

The District Court and the Commission also had before them the facts and ruling that appear in the first *Terminal* case (224 U. S. 383).

In this case the Government had sued to enjoin an alleged unlawful combination in restraint of interstate commerce, claiming that the St. Louis trunk lines then owning the Terminal, were parties to such an unlawful combination under the contract then existing between them.

The charge was sustained by this Court and the Terminal combination was condemned as unlawful, but the Court made the constructive suggestion that the combination would become lawful if modified (a) so as to make the Terminal Company the "bona fide agent and servant" of every railroad line (whether a proprietor or not) which shall use its facilities, and (b) so as to permit any other railroad not a proprietor to use its facilities. The Terminal cases show that these conditions contained in the decree, were complied with.

Since appellants contend that the rights or privileges thus extended by the Terminal under the compulsion of said decree, to all non-proprietary lines including appellants', entitled appellants in the absence of contract, to use the intervening rails and bridges of the Terminal as their own, and to use the intervening service of the Terminal as that of appellants' "servant or agent," the facts, reasoning and conclusions in the *Terminal* case are important to be further considered here.

In the main case (*U. S. v. Terminal R. R. Ass'n*, 224 U. S. 383, at 395), the Court described the Terminal situation in St. Louis and East St. Louis thus (italics ours):

"Though *twenty-four lines of railway converge at St. Louis, not one of them passes through.* About one-half of these lines have their termini on the Illinois side of the river. The others, coming from the west and north, have their termini either in the city or on its northern edge. To the river the city owes its origin, and for a century and more its river commerce was predominant. It is now the great obstacle to connection between the termini of lines on opposite sides of the river and any entry into the city by Eastern lines. The cost of construction and maintenance of railroad bridges over so great a river makes it impracticable for every road desiring to enter or pass through the city to have its own bridge."

The monopoly control of the Terminal, that had resulted from the above facts, is described thus (at p. 397):

"The result of the geographical and topographical situation is that *it is*, as a practical matter, *impossible for any railroad company to pass through, or even enter St. Louis*, so as to be within reach of its industries or commerce, *without using the facilities entirely controlled by the Terminal Company*"; (and at pages 404-405):

"The railroad systems and *the coal roads converging at St. Louis*, which are *not associated* with the proprietary companies *are under compulsion to use the Terminal system*, and yet have no voice in its control."

The Court pointed out the factor that made the Terminal combination unlawful (at p. 398):

"The physical conditions which compel the use of the combined system by every road which desires

to cross the river, either to serve the commerce of the city or to connect with lines separated by the river, is the factor which gives greatest color to the unlawfulness of the combination as now controlled and operated"; and at pages 409-410:

"• • • • The illegal restraint upon commerce among the states which we here find to exist consists in the possession acquired by the proprietary companies through the means and with the object we have stated of dominating commerce among the States carried on by other railroads entering or seeking to enter the City of St. Louis and by which such railroads are compelled either to desist from carrying on interstate commerce or to do so upon the terms imposed by the proprietary companies. This control and possession constitute such a grip upon the commerce of St. Louis and commerce which must cross the river there, whether coming from the east or west as to be both an illegal restraint and an attempt to monopolize. • • • •"

The Court described the essential nature of the transportation service of a terminal carrier thus (at pp. 401-2):

"We are not unmindful of the essential difference between terminal systems properly so described and railroad transportation companies. The first are but instrumentalities *which assist the latter* in the transfer of traffic between different lines, and in the collection and distribution of traffic."

Having pointed out the factor in the Terminal combination that made it unlawful, and described the proper functions of a terminal carrier, the Court made a con-

structive suggestion for the elimination of the unlawful factor, saying (at p. 410):

> "Plainly the combination which has occurred *would not be an illegal restraint* under the terms of the statute *if it were* what is claimed for it, *a proper terminal association* acting *as the impartial agent of every line which is under compulsion to use its instrumentalities.*"

The Court disposed of the case by directing a decree requiring the fourteen trunk lines then proprietors of the Terminal to amend their contract in two respects (p. 411):

> First. By providing for the admission "of any existing or future railroad to joint ownership and control," etc.;
>
> "Second. Such plan of reorganization *must also provide definitely for the use of the terminal facilities by any other railroad not electing to become a joint owner, upon such just and reasonable terms and regulations as will, in respect of use,* character and cost of service, place every such company upon as nearly an equal plane as may be with respect to expenses and charges as that occupied by the proprietary companies."

The decree that ultimately resulted from this mandate, provided in substance (*Terminal* v. *U. S.*, 266 U. S. 17, at 23), that *any other railroad* not electing to become a joint owner, but *wishing to use the facilities of the Terminal, should be permitted to do so* upon such terms as will, in respect of use, character and cost of service, place every such railroad upon as nearly an equal plane

as may be, with respect to expenses and charges, as that occupied by the proprietary companies.

We respectfully submit that this decree conclusively placed the Terminal in its relation to non-proprietary carriers (like the O'Fallon and Manufacturers), in the position of being either a *joint user* with them of its facilities, or *their agent and servant* in itself performing the intermediate service over its facilities.

The necessary effect of such a relation was that the rails and bridges of the Terminal that filled the physical gap between the rails of the carriers having their *termini* on the east side of the river, and those having their *termini* on the west side of the river, became *equivalent to extensions of the rails of such carriers over the intervening facilities of the Terminal.* This enables each line-haul carrier, including the O'Fallon, that transports freight into East St. Louis, to use the facilities of the Terminal in all respects and with the same effect, *as though they were extensions of its own rails,* for the purpose of reaching and interchanging traffic with trunk lines on the west side of the river, and for the purpose of making delivery of freight destined to industries in St. Louis that are served by either the Terminal or by the Manufacturers, or by those of the west side trunk lines (like the Wabash, Missouri Pacific, Frisco and Burlington) that have terminal and switching systems of their own in St. Louis.

As Commissioner Taylor said in his dissenting opinion (R., 101) (italics ours):

> "• • • *the intervening tracks of the Terminal* Railroad Association of St. Louis • • • constituted a *bridge between all East St. Louis and St. Louis lines,* and • • • *were subject to their joint use*—an

important factor in determining whether the two properties were being operated as a single system."

The further effect of the decrees in these Terminal cases is, that when the appellants (or any other lines) cause the Terminal to itself perform the intervening transportation, the Terminal does so as the "servant or agent" of appellants. In any case, the intervening gap in the transportation service is filled by or for appellants. Consequently appellants do furnish *a complete chain,—a single unit of transportation service.*

Appellants respectfully submit that the District Court erred in refusing to give complete effect here, to the decree in the Terminal cases, by erroneously limiting its effect to cases in which the intervening service of the Terminal was between *different* tracks *of the same carrier.* This appears from the following excerpt from the opinion of the District Court (R., 135-136) (italics ours):

> "It may be, that for the legal purposes involved in those cases, the Terminal *is an agent or servant* of *every road connecting with it which uses its facilities.* But we are dealing now with a matter of statutory construction—the question being, whether, in this statute, 'operated as a single system' was meant to include such a situation as is here present. The fact of a mere physical break in the trackage does not seem to us to be determinative. *The Wabash*, which goes *both east and west from St. Louis, might, within this statute, be a 'single system,'* even though there be *a short break in its physical connection.* Such conclusion might not be affected, even though that break is bridged by an entirely independent carrier, if *the only place there-*

in of such independent carrier is that of *transfer from one Wabash trackage to another.*"

It is obvious that if, under the District Court's above illustration, the Wabash lines east and the Wabash lines west "might within the statute be a single system" even though there be a short break filled by the facilities and service of the Terminal, then it is equally true that the Busch line east (the O'Fallon) and the Busch line west (the Manufacturers), should have been held a single system under the Act, because (1) the District Court had found common *ownership*, control and management, *i. e.*, both of these carriers were "Busch" lines, and (2) a controlling reason why the Court refused to find single system operation, was because of the same physical gap that exists between the Wabash lines, although the Act expressly provides that *separate corporate ownership* shall not prevent two carriers from being entitled to single system treatment.

The record fails to show whether the Wabash lines east are held under the same or a different corporate charter from the Wabash lines west. If they are held under different charters then they constitute "a group" of carriers "operated as a single system", and the District Court's Wabash illustration is on all fours with the O'Fallon case. If they are held under the same charter, the Act does not apply, because then the Wabash System consists of only one railroad not "a group" of railroads.

So it appears that the District Court erred in its interpretation of the Act, and also in refusing to hold that under the Terminal decree there is no such transportation gap between the lines of appellants as

will prevent them from being given single system treatment under the Act.

Conclusion: For these reasons and upon the grounds and authorities stated above, appellants respectfully submit: that under the law and the undisputed evidence, they were entitled to single system treatment; that the finding, rulings, decree and order *contra,* were without any evidence to support them and were contrary to the undisputed evidence and to the law applicable thereto; that the District Court and the Commission erroneously misconstrued the statute, and should have set aside the Commission's order; and that upon these grounds the decree below should be reversed, with directions to enter a decree in favor of appellants, setting aside as void the order of the Commission.

IX.

COMPLIANCE BY THE COMMISSION WITH THE RATE-MAKING RULE OF SECTION 15a IS A CONDITION PRECEDENT TO THE ENFORCEMENT OF ITS RECAPTURE PROVISIONS. THE ORDER IS VOID BECAUSE DURING NONE OF THE RECAPTURE PERIODS HAD THE RATE-MAKING PROVISIONS BEEN COMPLIED WITH.

1. The rate making rule of paragraph (2) and the recapture provisions (paragraphs (5) and (6) of Sec. 15a) are inter-dependent. Neither would have been enacted without the other. Performance by the Commission of its duty under the rate making rule by substantial compliance therewith is therefore a condition precedent to recapture.

(a) THE INTER-DEPENDENCE OF THE RATE MAKING RULE AND THE RECAPTURE PROVISIONS APPEAR ON THE FACE OF THE ACT AND FROM THE HISTORY OF THE TIMES.

Prior to the Transportation Act the statute contained no rate-making rule applicable to the rates of the carriers as a whole, or as a whole in any rate group composed of a number of carriers. Sec. 1 provided, as it now does, that all rates should be just and reasonable. A legislative standard for individual rates was thus prescribed. Aggregate revenues and aggregate net operating income were merely the product of such separately established rates. Any carrier which, under such rates, failed to earn a fair return upon the value of its own property, had the constitutional right to demand that its rates be so advanced

as to yield it a fair return. Since railroad traffic is largely competitive, the practicability of enforcing such a right depended upon whether its competitors could make a similar showing, and if so, to what extent. This situation is illustrated by the *Minnesota Rate Cases*, 230 U. S. 352 in which this Court held that the rates established by the State were not confiscatory as applied to the Great Northern and Northern Pacific, but were as to the Minneapolis and St. Louis. As the Minneapolis and St. Louis was in competition with the other carriers it was, of course, unable to take advantage of the decision in its favor. It was a well known fact at the passage of the Transportation Act that similar situations existed elsewhere. *Dayton-Goose Creek Ry. Co. v. United States*, 263 U. S. 456, 479.

In order to provide a rule of rate-making in support of the maintenance of an adequate system of national transportation under which efficient service by all carriers might be maintained, Sec. 15a was enacted. Paragraph (2) of that section makes it the duty of the Commission so to adjust the rates that the carriers as a whole, or in regional groups, shall obtain a fair return on their aggregate values. The history of the times and the legislative history of the Act warrants the statement, that this rule of rate-making was established in the belief that without it,—under a scheme of rate-making whereby aggregate earnings for a group or for the carriers as a whole were the product of separately established rates,—there was no assurance that such aggregate earnings would be sufficient to maintain the adequate national transportation system which the statute was intended to insure.

It was anticipated that this new rule of rate-making would result in substantial increases in rates and that

the net railway operating income of certain carriers would be increased beyond that which they would have received under the old order of things. It was therefore provided in paragraph (6) that if "under the provisions of this section" (Sec. 15a), any carrier received in any year a net railway operating income in excess of six per centum of the value of its railway property, one-half of such excess should be kept in a reserve fund to be established under the provisions of said section, and that the remaining one-half, declared by paragraph (5) to be held by it as trustee for the United States, should be paid to the Commission for the United States.

The interdependence of these two clauses appears on the face of the Act and in paragraph (5), which reads:

> "Inasmuch as it is impossible (without regulation and control in the interest of the commerce of the United States considered as a whole) to establish uniform rates upon competitive traffic which will adequately sustain all the carriers which are engaged in such traffic and which are indispensable to the communities to which they render the service of transportation, without enabling some of such carriers to receive a net railway operating income substantially and unreasonably in excess of a fair return upon the value of their railway property held for and used in the service of transportation, it is hereby declared that any carrier which receives such an income so in excess of a fair return, shall hold such part of the excess, as hereinafter prescribed, as trustee for, and shall pay it to, the United States."

(*b*) THE RATE MAKING RULE AND THE RECAPTURE PROVISIONS HAVE BEEN HELD BY THIS COURT TO BE INTERDEPENDENT PARTS OF A SINGLE SCHEME OF LEGISLATION.

That the recapture and rate-making provisions are thus interdependent, and together constitute a single plan, has already been recognized by this Court. That the Transportation Act was a means of meeting the conditions just described, was recognized in the decisions of this Court in *Dayton-Goose Creek Railway Co.* v. *United States*, 263 U. S. 456; *Wisconsin R. R. Commission* v. *C. B. & Q.*, 257 U. S. 563, and *New England Divisions* case, 261 U. S. 184. The constructive character of the legislation and the effort of the Act affirmatively to build up a system of railroads, is stated in *Dayton-Goose Creek Railway Co.* v. *United States*, *supra*, 478, it being declared that the purpose of creating a comprehensive system of rate-making resulted in the Transportation Act, which "is carefully framed to achieve its expressly declared objects" (p. 479). "The steps prescribed in the Act," it was there said, "constitute a direct and indirect fixing of rates"—direct by virtue of the requirement in paragraph (2) that the Commission shall exercise its power to "prescribe reasonable rates"; and indirect by virtue of the recapture provisions, through which "Congress is enabled to maintain uniform rates for all shippers and yet keep the net returns of railways * * * to the varying percentages which are fair respectively for them." To emphasize the view that these two methods of rate fixing—the direct and the indirect—were interlocking parts of a single plan or system, the Court, in addition to its previous statement that "the recapture clauses are thus

the *key* provision of the whole plan," declared later, that "the control of the excess profit *due* to the level of the whole body of rates is the *heart* of the plan."

It was, apparently, for this reason that the Court, in *Dayton-Goose Creek Ry. Co.* v. *United States, supra,* at page 480, said that the *validity* of the plan depended on two propositions: First, that from the shipper's standpoint, rates necessary to pay a fair return on group value were reasonable; and, Second, that the group rate making plan necessarily yielded to some roads incomes beyond what they were entitled to "as of constitutional right." When the Commission fails, as it has, to enforce the rate making rule the soundness of the second proposition becomes, at least, extremely doubtful. The consideration for the declaration of trust will, in that case, have failed.

(c) SINCE THESE PROVISIONS WERE INTENDED BY CONGRESS TO BE INTER-DEPENDENT, SUBSTANTIAL COMPLIANCE BY THE COMMISSION WITH THE RATE MAKING RULE IS A CONDITION PRECEDENT TO THE OPERATION OF THE RECAPTURE DEVICE.

Compliance with paragraph (2) is therefore prerequisite to the creation of the trust established by paragraph (5) and to recapture under paragraph (6). Congress did not provide that any carrier earning in excess of six per cent. upon the value of its property under any set of rates should hold one-half thereof as Trustee for the United States. Even under the reasoning of this Court in the *Dayton-Goose Creek* case, if the recapture provision alone had been enacted, it would have been of doubt-

ful constitutionality. That is to say, if the old scheme of rate-making had been continued in effect, whereby a standard for individual rates alone was provided, it is at least very doubtful whether a provision that any carrier earning more than six per cent. of the value of its property out of the net earnings produced by such individual rates, each in itself reasonable, could have been required to pay any part of such excess over to the United States. Such a law, it appears, would have been an appropriation of property already vested, not a regulation of commerce, and could not have been sustained even if accompanied by the declaration of a trust. The whole legislative intent contemplated the establishment of rates, higher than under existing standards, for the purpose of insuring an adequate national transportation system, under which certain carriers, would earn higher returns than under the existing system, and could be compelled to hold in trust a part of the excess over six per cent. on the value of their property. This intent is plainly evidenced in paragraph (5).

Recapturable earnings, therefore, are limited to those derived through compliance with this rate-making plan. This is so because paragraph (6) expressly limits recapture to earnings received "under the provisions" of section 15a, and because such was the legislative intent drawn from the Act as a whole. As pointed out by this Court in the foregoing cases, it was recognized when the Act was passed, that the net railway operating income of the carriers as a whole was inadequate to achieve the purposes of the Act. A substantial increase in rates was not only contemplated but was recognized as necessary. If, notwithstanding this fact, the Commission had permitted the

rates to remain as they were and made no attempt to comply with the rate-making provision, it would hardly be contended that any carrier with excess income derived under rates made under the theretofore existing scheme of regulation would have held any part thereof as trustee.

2. In no event can income arising prior to August 26, 1920, be subjected to recapture, because none of the carrier's net railway operating income during this period was received under the provisions of Sec. 15a.

Prior to August 26, 1920, none of the carriers in the United States received any income whatever "under the provisions of" Section 15a. The Report and Order of the Commission, however, declares a trust in favor of the United States for one half of the carrier's income in excess of six per cent. for the period from March 1, 1920 to December 31, 1920 (R., 104). The rates established by the Commission in *Increased Rates*, 1920, 58 I. C. C. 20, the first to be authorized by the Commission under paragraph (2) of Section 15a (the rate making rule), did not become effective until August 26, 1920 (*Reduced Rates 1922*, 68 I. C. C. 676, 734; R., 265). Until that time rates remained as they were at the termination of Federal control. Clearly, during this period the carrier received no income whatever "under the provisions of" Section 15a. Therefore no trust arose under paragraph (5) and no excess income under paragraph (6). To hold otherwise would be to hold that the recapture and rate making provisions are entirely independent of each other. The Commission's order proceeds upon the theory, therefore, that the recapture provisions became immediately operative upon the passage of the Act, irrespective of any compliance

or attempted compliance with the rate making provisions of paragraph (2). Those parts of the order which require the creation of a reserve fund out of the income of the last ten months of the year 1920, which seek to enforce a trust in respect of any part thereof are therefore void.

The recapture device was clearly intended to operate only on the income which would arise through the execution of Section 15a. Not only is the interdependence of the direct and indirect methods of rate fixing made plain, by paragraph (6) is explicit to the effect that the trust declared attaches only to the excessive portion of an income arising "under the provisions of this section."

3. No earnings are subject to recapture because the Commission has not established the rates prescribed by Section 15a.

In *Reduced Rates 1922*, 676, 680 (decided May 16, 1922), the Commission said: "Since August, 1920, the carriers as a whole, or as a whole in their respective groups, have failed by a considerable margin to earn the authorized return." In the same case (p. 734) it fixed the fair rate of return from and after March 1, 1922, at 5¾%. In the instant case, decided February 17, 1927, the Commission said (R., 67) of the rates resulting from the action taken by it under the rate making rule:

> "As a matter of fact, the railroads have not earned on the average, the fair return which the rates were designed to produce."

The Commission itself, therefore, is authority for the statement that the rate making rule of paragraph (2) has never been complied with since the passage of the Act.

The history of the times warrants the statement that it was the purpose and expectation of Congress that under Sec. 15a the carriers as a whole should be insured more generous treatment than in the past in order to insure the maintenance of an "adequate national system of transportation." It cannot be doubted that in providing that the general level of rates should be made such as to yield a fair return upon the aggregate value of all railroad property with the use of the recapture device as a check upon excessive earnings thereunder, Congress intended that the returns on such aggregate value should be at least as high as under the old system of rate making. For ten and a half years preceding Federal control, the net railway operating income of the carriers as a whole was 5.2 per cent. on their property investment accounts. (*51st Annual Report of Interstate Commerce Commission*, December 1, 1927, p. 109.) For the years 1921 to 1926, inclusive, it was 4.2%. (*51st Annual Report of Interstate Commerce Commission, supra.*) The investment account of the carriers may not be taken as determinative of their value. These figures, made on a comparable basis in the two periods, however, show clearly that the purpose of the rate making rule with its accompanying recapture device has not been realized. Looking at the country as a whole, there has not been substantial compliance with the Act on the part of the Commission. Its action in reducing rates in all groups ten per cent. in 1922, notwithstanding its finding that the rate of return was far below that required by paragraph (2) and its refusal in *Revenues in Western District 1925*, 113 I. C. C. 3, to permit any

advance in the rates of the Western carriers demonstrate that after its first vain effort to comply with the rate making rule of paragraph (2) it has been content to allow revenues of the carriers to be determined as before, viz., by the aggregate of separately established rates. Throughout the period there has been neither substantial compliance with the rate making rule nor attempted compliance therewith on the part of the Commission.

To test the rate of return in reduced rate 1922, *supra*, page 687, note 1, the Commission brought this basic valuation down to date by adding the net additions to investment. Applying the same method so as to bring such basic valuation (based, however, on pre-war costs and therefore producing minimum values) down to each of the recapture periods it appears that during none of such periods did the date of return equal the fair rate of return fixed by the Commission under the Act (Monroe R., 266-268, Exhibit 16; R., 272-276).

The record in this case shows a similar lack of compliance in respect of the Eastern group, within which the O'Fallon is included.

The valuation of all the railroads in the Eastern group ($8,800,000,000), made by the Commission in *Increased Rates 1920*, *supra*, was based on pre-war costs, and would have been much greater if substantial effect had been given to price levels then and since prevailing. The Commission apparently applied then the same valuation theory as in the order here attacked. The method by which Mr. Monroe brought this basic valuation to date by adding the net additions to investment, is the one that the Commission, itself, used in *Reduced Rates 1922*, *supra*,

page 687, note 1. The figures were worked out on several bases, since it is not clear as of what date the finding of $8,800,000,000 is effective, and the Illinois Central Lines are located in both the Eastern and Southern groups. Assuming that the $8,800,000,000 be taken as the value as of December 1, 1920 (which is most conservative for the purposes of this argument), and that *all* of the Illinois Central income be included in that of the Eastern group, the following table gives the result:

Value	Rates of Return 1921	1922	1923
1. $8,800,000,000			
2. Plus net increases in investment	3.33	4.11	5.30
3. Plus net increases in investment, less depreciation, plus working capital	3.37	4.21	5.42

If the Illinois Central income be entirely *excluded* the rates of return shown above will all be somewhat reduced. However, if the value of $8,800,000,000 be assumed to have been fixed as of December 31, 1919 (which seems a reasonable interpretation of *Increased Rates 1920*), and the Illinois Central income be again included within the income of the Eastern group, the result is as follows:

Value	Rates of Return 1921	1922	1923
1. $8,800,000,000			
2. Plus net increases in investment	3.29	4.04	5.28
3. Plus net increases in investment, less depreciation, plus working capital	3.29	4.08	5.37

In fact, even if the $8,800,000,000 be assumed to be the value for the years 1921 and 1922, although it is shown (R., p. 272) that over $200,000,000 was spent in additions and betterments during the year 1921, and almost the same amount during 1922, the carriers in the Eastern group did not earn in excess of 4½%. It is, therefore, clear that for the years 1920, 1921 and 1922, the income of the carriers fell far below a fair return, on the most conservative basis.

While the earnings of the Eastern group carriers, as shown in the foregoing tabulations were in excess of 5 per cent. in the year 1923, it should be noted that the valuation employed in *Increased Rates, 1920, supra*, upon which these calculations are based, is fundamentally a pre-war valuation, not reflecting the increase in values due to the upward change in costs of construction which have occurred since the war began. As stated on page 32 of the Commission's Report (R., 66) said aggregate value figured "was less than the aggregate recorded investment in road and equipment and working capital, * * *" In that valuation, made in 1920 and at a time when it was commonly believed that the high level of prices existing since the beginning of the war would recede, the Commission was guided by the same fundamental conceptions applied in its determination of value in this O'Fallon case, and did not accord weight to the higher construction costs and values then existing. Even a moderate allowance resulting from a slight consideration of the higher costs and values then existing would reduce the rate of return of the carriers in 1923, below 5 per cent.

If, as appellants contend, substantial compliance with the rate making provisions is a condition precedent to re-

capture, then it follows that there may be no recapture unless such substantial compliance fairly appears from the record. The Commission has not completed its valuation work and has issued but few final valuations. The figures employed in all the foregoing calculations may properly be regarded as minimum figures based primarily upon a summary valuation made immediately upon the passage of the Act, to fit the exigencies of the time and, as stated, takes no account of the effect of the increased price level. Even under such minimum valuation the rate of return on such a valuation is less than that fixed by the Commission as a reasonable rate of return in the year 1923, as well as in all other years. When proof of aggregate value is availing, as already stated, the Commisson in its Report, dealing with the country as a whole, says that at no time since the passage of the Act have the carriers received the rate of return contemplated thereby. Under these circumstances, it is respectfully submitted that there may be no recapture until it shall clearly appear that there has been substantial compliance with the rate making provision.

We are not unmindful that the requirement of paragraph (2) is that the rates established by the Commission shall be such that the carriers will earn an annual income "equal as nearly as may be to the fair return upon the aggregate value of the railroad property of such carriers" and does not require mathematical exactness therein. Congress knew that the task imposed on the Commission of readjusting the rates of all the railroads embraced within a particular group, so that such group would earn an annual operating income equal to a fair return on the value of the property, would be difficult to perform with

complete exactness. Therefore, complete exactness in the resulting income was not required, but substantial exactness—a result approximating exactness as closely as was reasonably practicable,—was required, and was expressed by the words "as nearly as may be."

This must be the intent because any other construction would permit the Commission at its uncontrolled discretion to defeat the express purpose of the statute. Minor variations could not defeat this purpose, substantial ones would.

X.

THE ORDER IS INVALID BECAUSE THE PROVISIONS OF THE STATUTE REQUIRING THE CREATION OF A RESERVE FUND USABLE ONLY FOR RESTRICTED PURPOSES IS UNREASONABLE AND IN VIOLATION OF THE FIFTH AMENDMENT.

In a preceding chapter are stated the grounds for the conclusion that only that part of the excess earnings, which is payable to the Government, is impressed with a trust by paragraph (5) and that all of the balance are received by the carrier as its private property. Under the provisions of paragraph (6) the half of the excess not impressed by the trust must be maintained by the carrier in a reserve fund. In paragraph (8) it is provided that this reserve fund shall be accumulated until it equals 5 per cent. of the value of the property. Paragraph (7) provides that the carrier may draw upon the fund "for the purpose of paying dividends or interest on its stocks, bonds or other securities, or rent for leased roads, * * * to the extent that its net railway operating income for any year is less than a sum equal to six per centum of the value of the railroad property * * *."

The carrier consequently is deprived of the free use of this money. Such a deprivation constitutes "a taking" of the property. *Chicago, Milwaukee & St. Paul Ry. Co.* v. *Minnesota*, 134 U. S. 18, 145; *United States* v. *Lynah*, 184 U. S. 445, 470. This money can never be used even for the designated restricted purposes, excepting in the event that the income of the carrier is deficient, and then only to the extent of that deficiency. This is an arbitrary re-

striction and without a reasonable basis. It is no proper part of the regulation of the carrier in its duty to the public to limit invade the field of its corporate or private purposes unrelated to the discharge of its quasi-public or common carrier duties, and to require the impounding of its private funds, making impossible their use for any common carrier purpose, and restricting their use for private purposes. The power of regulation extends only to those functions of the carrier which are quasi-public in nature. It is therefore submitted that this provision of Section 15a, and the Commission's order based thereon, are unconstitutional and in derogation of the Fifth Amendment in that they are an effort to take private property without just compensation and without due process of law.

XI.

THE DISTRICT COURT ERRED IN HOLDING THAT INTEREST IS PAYABLE ON THE AMOUNTS ORDERED TO BE PAID BY THE O'FALLON; AND IN HOLDING THAT SUCH INTEREST BEGAN TO ACCRUE NINETY DAYS AFTER THE DATE, FEBRUARY 15, 1927, WHEN THE COMMISSION ENTERED ITS ORDER.

The petition attacked the order partly on the ground that interest is not recoverable (R., 28). The Commission ordered (R., 105) that interest at six per cent. per annum be paid on each amount asserted to be recapturable, from May 1 of each calendar year after the close of each recapture period (R., 105); this, although the Commission did not formulate its order until February 15, 1927, more than four years after the end of the last recapture period, and did not inform the O'Fallon of the particular amounts claimed by the Commission as recapturable, or make demand therefor, until March 31, 1927 (R., 265-266). The order had been entered on the Commission's records February 15, 1927, but had not then been published or served. The amount of interest so figured to May 1, 1927, is $61,450.59.

The District Court held that interest is payable, and that it began to accrue ninety days after February 15, 1927 (R., 139), the date of the Commission's order.

The statute (paragraph 6, Section 15a) is silent as to interest, but requires the recapturable amounts to be paid "within the first four months following the close" of the recapture periods.

Appellants contend that no interest is payable, and that if held to be payable, it has not yet started to run, because the claim of the Government has not yet been liquidated within the established doctrines relating to interest. The following doctrines seem well established:

(1) In the absence of a statutory obligation to pay interest it can be recovered only (*a*) when the obligation to pay is imposed by contract expressed or implied, or (*b*) when recoverable as compensation for the wrongful detention of money or other property; *Lincoln* v. *Claflin*, 7 Wall. 132, 139; *Redfield* v. *Iron Co.*, 110 U. S. 174, 177; 33 C. J. 182.

(2) A trustee is not chargeable with interest on the trust fund unless he has been guilty of some fault or neglect, as where he has failed to perform a duty of investment (*In re Nesmith*, 148 N. Y. 609, 35 N. E. 942), or when he applies money to his own use;

(3) "• • • interest is not recoverable upon unliquidated demands, but is allowable only after such demands shall have become *merged in a judgment*. In order to recover interest there must be a fixed and determinate amount which could have been tendered and interest thereby stopped" (33 C. J. 211; italics ours).

See also:

Redfield v. *Iron Co.*, 110 U. S. 174, 177;
Southern Pacific R. R. Co. v. *U. S.*, 228 U. S. 618, 632, 633;

International Paper Co. v. *Beacon Oil Co.*, 290 Fed. 45, 53;
Great Northern Ry. Co. v. *Philadelphia Co.*, 242 Fed. 799, 803;
Valentine v. *Quackenbush*, 239 Fed. 832, 835.

Security State Bank v. *Gannon*, 40 S. D. 495, 168 N. W. 125, 126, bears substantial analogy to the instant case. The suit was by a state bank examiner to hold stockholders liable on their constitutional liability for debts of the bank. It was held that interest ran from the date of the judgment that fixed the amount of the liability, and not from the date of the attempted assessment by the bank examiner.

In this O'Fallon case the carrier, as trustee, has been guilty of no wrong or neglect. If it holds any money in trust, (which it denies in good faith), it received the money lawfully and its custody is lawful.

The claim of the Government for the amount fixed by the order of the Commission as claimed to be recapturable, has not yet been "liquidated" in amount. It is still in dispute in this suit as to both liability and amount. The O'Fallon denies that it holds any money in trust under the statute, and contends that if it should be held that it has some trust funds in its custody, such custody is lawful and that the disputed amount has not yet been liquidated by the judgment of any court.

It is established that the Commission is not a court and has no judicial power; *Baer Brothers Merc. Co.* v. *D. & R. G.*, 233 U. S. 479. The order of the Commission, therefore, is not a judgment which can have the effect of liquidating a claim within the meaning of the law as stated. See the group of cases last above cited.

Appellants contend that the court below erred in holding (R., 139), that the determination by the Commission of the amount claimed to be recapturable is a sufficient liquidation for interest purposes. The law, in requiring a "judgment", obviously contemplates the decision of a tribunal that acts in a judicial capacity, in order to convert an unliquidated disputed claim which is predicated on a trust, into a "liquidated" claim. This ruling of the Court below is, therefore, hostile to the essential reason of the doctrine.

Moreover, there is no analogy here, to interest recoverable as damages on reparation allowances made by the Commission. In such cases the liability of the carrier for both principal and interest is fixed by established law. It accrues on the date when the carrier caused the damages by wrongfully violating the Act, as by making overcharges. (*Arkadelphia* v. *St. L. S. W. Ry.*, 249 U. S. 134, 143). It is immaterial in such cases that the carrier may dispute the validity and amount of the claim, because the accrual of interest and the date when it begins to run, and the carrier's liability therefor, are fixed by law and known by the carrier when it violates the Act.

But when, as here, the beneficiary of a trust makes a claim upon his trustee for the payment of alleged trust funds admitted to be lawfully in the trustee's custody, it is essential to the running of interest that the amount of the claim be first liquidated in a judicial proceeding. Since no such liquidation has yet occurred, interest has not commenced to run.

Appellants also contend that,—assuming the carrier to be liable at all,—the Court below erred in holding that interest began to run ninety days after the date (Febru-

ary 15, 1927), when the Commission entered the order on its own records.

Since the claim has not been liquidated by a judgment, it seems clear that interest could not possibly begin to run until after the making of demand for payment of the amount liquidated by such a judgment. And assuming that the Commission had authority to allow ninety days grace (R., 105), equity would seem to require that interest begin to run ninety days after the claim has been liquidated by such a judgment, and after demand for payment of such liquidated amount has been made on the carrier.

XII.

THE COURT ERRED IN THE EXCLUSION OF EVIDENCE.

The law is well established that if a constitutional issue is present in the case, the appellants are entitled to a trial *de novo* before the *Court*, with the right to introduce evidence. This was directly decided in the case of *Manufacturers' Railway Company* v. *Interstate Commerce Commission*, 246 U. S. 457, 489-490, in which the Court held that, where the issue of the taking of property without due process was presented, the railroad was entitled to a trial *de novo* and to introduce evidence bearing on the issue, even though such evidence had not been introduced in the case before the Commission. The lower Court therefore was in error in excluding the evidence offered by appellants showing the value of the property. This evidence consisted of; the entire record before the Commission (R., 194, *et seq.*); the testimony of a competent witness as to the cost of reproduction of the property as of the recapture years; the testimony of competent witnesses to the effect that the reproduction costs determined by the Government engineers were conservative; and testimony showing in detail the true value of the property and the elements thereof (Offers of Proof, Nos. 8-16, incl.; R., 281-286).

The Court can not exercise its independent judgment except on competent evidence. The record before the Commission, as admitted by the District Court, is not substantive evidence in court of the facts pertinent to the issues made by the pleadings, but merely shows the

evidence upon which the Commission acted. In cases reviewing orders solely within the Commission's administrative field, and where the Court's authority is limited to a review of the Commission's action for the purpose of determining whether in excess of its statutory authority, based on an error of law or unsupported by the evidence, no other evidence may be offered. In such cases the record before the Commission is not offered as independent evidence of facts upon which the Court is to reach a conclusion, but merely as evidence of what the Commission had before it.

The appellants below, therefore, offered in Court (R., 178) the evidence before the Commission as substantive evidence of the facts. This was done under a stipulation (R., 178) that if the Court should rule that it was competent for the appellants to introduce evidence in Court, the record so offered should be received with like force and effect as though the witnesses had testified before the Court in person. The appellants also offered additional evidence in support of their allegations as to the true value of the property (R., 277-286). Both offers were rejected (R., 180, 286), and exceptions saved.

With reference to its ruling on the evidence, the Court delivered a separate opinion which was not officially reported but is printed in the Record (pp. 180-181). Here it stated its reasons for excluding the evidence. After stating that the carriers had had a hearing before the Commission, the Court said:

> "We think the function of the courts as to such actions of the Commission is limited to reviewing the action of the Commission with a view of testing whether it has failed to act in accordance with

> **the law governing its action and whether it has arbitrarily reached the conclusion at which it arrived. Obviously, a *review* of the action of the Commission must be upon the record before the Commission and none other because it was upon such record alone that the Commission should and is presumed to have acted. We think this view is required by numerous holdings of the Supreme Court of which the most recently reported is *Western Chemical Co.* v. *United States*, 271 U. S. 268, 271. Therefore, this court should not try this matter *de novo* but all evidence not before the Commission should be excluded."**

The Court's exclusion of the evidence followed from its erroneous conclusion that no constitutional issue was involved. An examination of the opinion in *Western Chemical Co.* v. *United States, supra*, indicates that it is typical of that class of cases where orders of an administrative nature have been in question and where the courts have regarded themselves as limited to the narrower scope of judicial review accorded where no constitutional question is presented. The decision in *Manufacturers' Railway Company* v. *United States, supra*, is authority for the proposition, which is admitted by implication by the lower court, that where a constitutional issue is involved, a trial *de novo* is guaranteed. The lower Court is inconsistent. In the part of its opinion just quoted, it states that it regards its function as limited to "reviewing the acts of the Commission with a view to testing whether it has acted *in accordance with the law* governing its action and whether it has arbitrarily reached the conclusion at which it arrived." Thus, although the Court declined in

the main opinion to upset the order unless confiscation were shown, it here plainly recognizes the narrower grounds of relief, based on errors of law.

If, as appellants contend, the Court erred in ruling that no case of confiscation was made by the pleadings, it is clear that all of this testimony was admissible and should have been received by the Court.

XIII.

THE DISTRICT COURT ERRED IN ADJUDGING THE COSTS AGAINST THE APPELLANTS.

The final decree (R., 148-149) directed a dismissal at the cost of the petitioners and did so notwithstanding the fact that the decree also cancelled and annulled so much of the Commission's order "as provides and directs the payment of interest for periods of time prior to May 17, 1927," and it permanently enjoined the Government and the Commission "from collecting or attempting to collect interest for the periods aforesaid" (R., 149).

Appellants contend that since one of the grounds on which the petition attacked the Order (R., 28) was because of its erroneous inclusion of interest in the amount directed to be paid by the O'Fallon, and since this contention of appellants was held by the trial court to be correct, and involved a substantial amount of money, it was inequitable and therefore erroneous, to adjudge against petitioners, the costs of the suit.

Respectfully submitted,

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December 11, 1928.

APPENDIX I.

Pertinent Provisions of Section 15a of the Transportation Act of 1920.

[41 U. S. Stat. at Large, C. 91, Sec. 422.]

SEC. 422. The Interstate Commerce Act is further amended by inserting after section 15 a new section to be known as section 15a and to read as follows:

* * *

"(2) In the exercise of its power to prescribe just and reasonable rates the Commission shall initiate, modify, establish or adjust such rates so that carriers as a whole (or as a whole in each of such rate groups or territories as the Commission may from time to time designate) will, under honest, efficient and economical management and reasonable expenditures for maintenance of way, structures and equipment, earn an aggregate annual net railway operating income equal, as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation: *Provided*, That the Commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust or unreasonable, and to prescribe different rates for different sections of the country.

"(3) The Commission shall from time to time determine and make public what percentage of such aggregate property value constitutes a fair return thereon, and such percentage shall be uniform for all rate groups or territories which may be designated by the Commission. In making such determination it shall give due consideration, among other things, to the transportation needs of the

country and the necessity (under honest, efficient and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation: *Provided*, That during the two years beginning March 1, 1920, the Commission shall take as such fair return a sum equal to 5½ per centum of such aggregate value, but may, in its discretion, add thereto a sum not exceeding one-half of one per centum of such aggregate value to make provision in whole or in part for improvements, betterments or equipment, which, according to the accounting system prescribed by the Commission, are chargeable to capital account.

"(4) For the purpose of this section, such aggregate value of the property of the carriers shall be determined by the Commission from time to time and as often as may be necessary. The Commission may utilize the results of its investigation under section 19a of this Act, in so far as deemed by it available, and shall give due consideration to all the elements of value recognized by the law of the land for rate-making purposes, and shall give to the property investment account of the carriers only that consideration which under such law it is entitled to in establishing values for rate-making purposes. Whenever pursuant to section 19a of this Act the value of the railway property of any carrier held for and used in the service of transportation has been finally ascertained, the value so ascertained shall be deemed by the Commission to be the value thereof for the purpose of determining such aggregate value.

"(5) Inasmuch as it is impossible (without regulation and control in the interest of the commerce of the United States considered as a whole) to establish uniform rates

upon competitive traffic which will adequately sustain all the carriers which are engaged in such traffic and which are indispensable to the communities to which they render the service of transportation, without enabling some of such carriers to receive a net railway operating income substantially and unreasonably in excess of a fair return upon the value of their railway property held for and used in the service of transportation, it is hereby declared that any carrier which receives such an income so in excess of a fair return, shall hold such part of the excess, as hereinafter prescribed, as trustee for, and shall pay it to, the United States.

"(6) If, under the provisions of this section, any carrier receives for any year a net railway operating income in excess of 6 per centum of the value of the railway property held for and used by it in the service of transportation, one-half of such excess shall be placed in a reserve fund established and maintained by such carrier, and the remaining one-half thereof shall, within the first four months following the close of the period for which such computation is made, be recoverable by and paid to the Commission for the purpose of establishing and maintaining a general railroad contingent fund as hereinafter described. For the purposes of this paragraph the value of the railway property and the net railway operating income of a group of carriers which the Commission finds are under common control and management and are operated as a single system, shall be computed for the system as a whole irrespective of the separate ownership and accounting returns of the various parts of such system. In the case of any carrier which has accepted the provisions of section 209 of this amendatory Act the provisions of this paragraph shall not be applicable to the income for any period prior to September 1, 1920. The value of such rail-

way property shall be determined by the Commission in the manner provided in paragraph (4).

"(7) For the purpose of paying dividends or interest on its stocks, bonds, or other securities, or rent for leased roads, a carrier may draw from the reserve fund established and maintained by it under the provisions of this section to the extent that its net railway operating income for any year is less than a sum equal to 6 per centum of the value of the railway property held for and used by it in the service of transportation, determined as provided in paragraph (6); but such fund shall not be drawn upon for any other purpose.

"(8) Such reserve fund need not be accumulated and maintained by any carrier beyond a sum equal to 5 per centum of the value of its railway property determined as herein provided, and when such fund is so accumulated and maintained the portion of its excess income which the carrier is permitted to retain under paragraph (6) may be used by it for any lawful purpose.

"(9) The Commission shall prescribe rules and regulations for the determination and recovery of the excess income payable to it under this section, and may require such security and prescribe such reasonable terms and conditions in connection therewith as it may find necessary. The Commission shall make proper adjustments to provide for the computation of excess income for a portion of a year, and for a year in which a change in the percentage constituting a fair return or in the value of a carrier's railway property becomes effective.

APPENDIX II.

[Report and Order of the Commission, pp. 70-71, R., 104-105]

ORDER

AT A SESSION OF THE INTERSTATE COMMERCE COMMISSION, HELD AT ITS OFFICE IN WASHINGTON, D. C., ON THE 15TH DAY OF FEBRUARY, A. D. 1927

FINANCE DOCKET No. 3908

EXCESS INCOME OF ST. LOUIS & O'FALLON RAILWAY COMPANY

FINANCE DOCKET No. 4026

EXCESS INCOME OF MANUFACTURERS' RAILWAY COMPANY

It appearing, That in compliance with the provisions of paragraphs (4) to (9), inclusive, of Section 15a of the Interstate Commerce Act this Commission entered upon an investigation into and concerning the matter of excess net railway operating income of the St. Louis & O'Fallon Railway Company and of the Manufacturers' Railway Company;

It further appearing, That a full investigation of the matters and things involved having been had, and this Commission having, on the date hereof, made and filed a report containing its findings of fact and conclusions thereon, which report is hereby referred to and made a part hereof;

It further appearing, That no amount of excess net railway operating income was received by the said Manufacturers' Railway Company during the periods covered by the investigation, but that the following designated amounts of excess net railway operating income were received by the said St. Louis & O'Fallon Railway Company for the periods stated:

Mar. 1 to Dec. 31, 1920, inclusive.....	$106,755.96
Jan. 1 to Dec. 31, 1921, inclusive.....	130,205.13
Jan. 1 to Dec. 31, 1922, inclusive.....	106,391.03
Jan. 1 to Dec. 31, 1923, inclusive.....	110,409.22

It further appearing, That under the provisions of paragraph (5) of said section, one-half of such excess net railway operating income is held by the said St. Louis & O'Fallon Railway Company as trustee for the United State; that, under the provisions of paragraph (6) of said section, one-half of such excess net railway operating income is recoverable by and payable to this commission within the first four months following the close of the period for which the computation is made; and that, to the extent required by the provisions of paragraphs (6) and (8), the remaining one-half of such excess net railway operating income is required to be placed in a reserve fund established and maintained by said St. Louis & O'Fallon Railway Company;

And it further appearing, That, on March 28, 1924, this Commission, by division 4, announced that interest on amounts of excess net railway operating income payable to the United States under said section would be required at the rate of six per cent. per annum, beginning four months after the termination of the period for which the said excess net railway operating income is computed:

It is ordered, That the amounts of excess net railway operating income which are held by the said St. Louis & O'Fallon Railway Company as trustee for the United States, under the aforesaid provisions, be paid to this Commission in Federal reserve funds, drawn to the order of the Interstate Commerce Commission and transmitted to George B. McGinty, secretary, Washington, D. C., within 90 days from the date hereof, together with interest thereon, as stated below:

With interest from—

May 1, 1921	$53,377.98
May 1, 1922	65,102.56
May 1, 1923	53,195.51
May 1, 1924	55,204.61

It is further ordered, That the remaining one-half of such excess net railway operating income be placed in a reserve fund, as required by paragraph (6) of said section, as aforesaid.

By the Commission.

GEORGE B. MCGINTY,
Secretary.